

Kandi Technologies Group, Inc.
Form 10-K
April 01, 2013

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934**

For the fiscal year ended December 31, 2012

or

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934**

For the transition period from _____ to _____

Commission file number 000-52186

KANDI TECHNOLOGIES GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation
or organization)

90-0363723

(I.R.S. Employer Identification No.)

**Jinhua City Industrial Zone
Jinhua, Zhejiang Province
People's Republic of China
Post Code 321016**

(Address of principal executive offices) (Zip Code)

(86-579) 82239856

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, Par Value \$0.001 Per Share

(Title of each class)

NASDAQ Global Market

(Name of exchange on which
registered)

Securities Registered Pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the common stock issued and outstanding and held by non-affiliates of the registrant, based upon the closing sales price for the common stock on the NASDAQ Global Market on June 29, 2012, the last business day of the registrant's second fiscal quarter, was approximately \$53,693,762. For the purposes of this calculation, executive officers, directors, and each person that owns 10% or more of our outstanding common stock are deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 22, 2013, the registrant had 32,539,867 shares of common stock, par value of \$0.001 outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this Annual Report) contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as anticipate, expect, intend, plan, will, we believe, ou believes, management believes and similar language. These forward-looking statements are based on our current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under Item 1, Business , Item 1A, Risk Factors and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. Our actual results may differ materially from results anticipated in these forward-looking statements. We base our forward-looking statements on information currently available to us, and we assume no obligation to update them. In addition, our historical financial performance is not necessarily indicative of the results that may be expected in the future and we believe such comparisons cannot be relied upon as indicators of future performance.

Although we believe that the expectations reflected in the forward looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results.

PART I

Except as otherwise indicated by the context, references in this Annual Report to we, us, our, Kandi, or the Company are to the combined businesses of Kandi Technologies Group, Inc. and its subsidiaries.

Item 1. Business.

Introduction

The Company was incorporated under the laws of the State of Delaware on March 31, 2004. On August 13, 2007, the Company changed its name from Stone Mountain Resources, Inc. to Kandi Technologies, Corp. On December 21, 2012, the Company changed its name to Kandi Technologies Group, Inc.

On June 29, 2007, the Company (Stone Mountain Resources, Inc.) executed an exchange agreement to acquire 100% of Continental Development Limited, a Hong Kong corporation (Continental) and its wholly owned subsidiary Zhejiang Kandi Vehicles Co., Ltd. (Kandi Vehicles). Continental became a wholly owned subsidiary of Stone Mountain. Thereafter, the business of the Company was that of Continental 's wholly owned subsidiary, Kandi Vehicles.

On December 31, 2010, Jinhua Three Parties New Energy Vehicles Service Co., Ltd. (Jinhua Service) was formed by a joint venture among the State Grid Power Corporation, Tianneng Power International, Inc. and Kandi Vehicles. The joint venture established the first Chinese electric super-mini automobile battery replacement service provider. The Company owns 30% of Jinhua Service.

In the first fiscal quarter of 2011, Jinhua Kandi New Energy Vehicles Co., Ltd. (Kandi New Energy) was incorporated by Kandi Vehicles and Mr. Xiaoming Hu, the Chairman and CEO of the Company.

On April 25 2012, The Company completed its acquisition of KO NGA Investment Limited and its subsidiaries, K S Asia Limited Group Limited, Yongkang K S Electric Limited and Yongkang Scrou Electric Co. (Yongkang Scrou), with consideration of 2,354,212 shares of the Company 's common stock. Yongkang Scrou manufactures various auto generators. On June 29, 2012, in connection with the completion of the Company 's internal reorganization, Yongkang Scrou became a wholly owned subsidiary of the Company.

The Company's organizational chart is as follows:

Kandi Vehicles has a 50% ownership interest and controls the Board of Directors in Kandi New Energy. Under Share Escrow and Trust Agreement, Loan Agreement, Contractor Agreement, between Kandi Vehicles and the other equity owner, Kandi Vehicles is entitled to 100% of the economic benefits, voting rights and residual interests (100% profits and loss absorption rate) in Kandi New Energy.

The primary operations of the Company are designing, developing, manufacturing, and commercializing electrical vehicles (EVs), all-terrain vehicles (ATVs), go-karts, and specialized automobiles related products for the PRC and global markets.

Business Overview

General

Kandi's products include off-road vehicles (which include ATVs, utility vehicles (UTVs), and go-karts), motorcycles, refitted cars and super-mini-cars.

	Year ended December 31					
	2012			2011		
	Units	Revenue	Units	Revenue		
All-terrain Vehicles (ATVs)	14,467	\$ 6,402,753	9,958	\$ 4,850,425		
Super-mini-cars ¹	3,915	19,034,936	1,077	6,253,517		
Go-Kart	34,517	30,794,415	25,757	22,923,669		
Utility vehicles (UTVs)	93	319,014	1,198	2,696,106		
Three-wheeled motorcycles (TT)	1,060	1,272,898	782	1,592,770		
Refitted car	115	3,172,417	70	1,860,661		
Auto generator	93,881	3,517,237	-	-		
Total	148,048	\$ 64,513,670	38,842	\$ 40,177,148		

1) Includes the products called CoCo and EV in 2011's filing, and Super-mini-cars are all EVs for year 2012.

Off-Road Vehicles

Kandi produces a wide range of go-karts, from the 90cc class to the 1,000cc class in cylinder displacement. Kandi also produces four-wheeled ATVs and specialized UTVs, which are ATVs special-fitted for agricultural and industrial use. Kandi started mass production of its go-karts in 2006.

During the twelve months ended December 31, 2012, the market condition for ATV products continued to recover. The Company continued to develop price competitive products to meet market demands, causing good results and successfully increasing the Company's sales. Revenues from our ATVs experienced an increase of \$1,552,328 or 32% in fiscal year ended December 31, 2012 from the previous year; this increase is primarily attributable to a 45.3% increase in unit sales, from 9,958 units in the fiscal year 2011 to 14,467 units in 2012, and the effect of a 9.1% unit price reduction.

In 2012, our go-karts segment experienced a significant increase in revenue of \$7,870,746, or 34.3% from fiscal year 2011. This increase was mainly attributable to a 34% increase in unit sales from 25,757 units in 2011 to 34,517 units in 2012. In the fiscal year ended 2012, the Company's successful development of meet-market-demands products achieved good results and resulted in increase unit sales.

Utility vehicles (UTVs) experienced a significant decrease in revenue from \$2,696,106 to \$319,014. This 88.2% decrease is due to a 92.2% drop in unit sales from 1,198 units in 2011 to 93 units in 2012. This significant decrease in sales is primarily attributable to high competition in the UTV market, and the fact that the UTVs manufactured by the Company are relatively high end and more expensive than comparable products offered by our competitors, which caused our average unit price to manufacture a UTV to increase significantly compared to the same period of last year.

Super-Mini-Car EVs

Our EV products segment experienced a significant increase in revenues. For fiscal year 2012, the revenues generated from our Super-mini cars increased by \$12,781,419 or 204.4% from \$6,253,517 in year 2011 to \$19,034,936 in year 2012, which was attributable to a 263.5% increase in unit sales from 1,077 units in year 2011 to 3,915 units in year 2012. This increase is primarily a result of certain beneficial local government's policies that encourage the development of EVs. For the fiscal year 2012, the average unit price of our Super-mini cars decreased 16.3%, due to a change adopted by the Company for most of the reporting period; the Company adopted a new battery exchange business model for the EVs and started selling EVs without batteries.

Motorcycles

Sales of three-wheeled motorcycle (TT) experienced a significant decrease in revenue from \$1,592,770 in year 2011 to \$1,272,898 in year 2012, despite an increase in unit sales from 782 units in year 2011 to 1,060 units in year 2012. This 20.1% decrease in revenue was mainly attributable to a average unit price decrease of 41.0%. The average unit price decreased in year 2012 primarily because the Company developed price-competitive gas-electric hybrid three wheeled motorcycles to meet the growing demand of such units in the Chinese markets.

Refitted Car

For the fiscal year ended December 31, 2012, revenues from our refitted car increased by \$1,311,756, or 70.5% from fiscal year of 2011. This was mainly attributed to the 64.3% increase in unit sales from 70 units in year 2011 to 115 units in year 2012. In addition, the Company refitted other companies' vehicles to meet special requirements for certain customers.

Auto generator

On April 25, 2012, the Company acquired Yongkang Scrou Electric Co. (Yongkang Scrou), whose main business is producing various auto generators. From April 25, 2012 to December 31, 2012, a total of 93,881 sets of auto generators were sold with sales totaling \$3,517,237.

The following table shows the breakdown of Kandi's revenues from its customers by geographic markets based on the location of distributors, during the fiscal years ended December 31, 2012 and 2011:

	Year Ended December 31			
	2012		2011	
	Sales Revenue	Percentage	Sales Revenue	Percentage
North America	\$ 7,243,257	11%	\$ 4,739,944	12%
Europe	1,639,990	3%	1,218,274	3%
China	55,630,423	86%	34,218,930	85%
Total	64,513,670	100%	40,177,148	100%

For the year ended December 31, 2012, about 60% of our sales in China, mainly off-road vehicle sales, were sold to Chinese export agents, who resell the Company's products to North America, Europe, and other regions. While for the year 2011, about 90% of our sales in China were sold to Chinese export agents, who resell the Company's products to North America, Europe, and other regions.

Recent Development Activities

On February 1, 2013, our wholly owned subsidiary, Kandi Vehicles signed a cooperation framework agreement with Shanghai Maple Guorun Automobile Co., Ltd. (Shanghai Maple), a 99% owned subsidiary of Geely Automobile Holdings Ltd. (Geely Auto), to establish a joint venture company, named Zhejiang Kandi Electric Vehicles Investment Co, Ltd. (the JV Company). The purpose of JV Company is to engage in the investment, research and development, production, marketing and sales of electronic vehicles in China. Geely Auto is one of the largest and most well-known automobile manufacturers in China. Pursuant to the terms of the framework agreement, the JV Company will be owned 50% by Shanghai Maple and 50% by Kandi Vehicles. The registered capital of the JV Company will be RMB1,000,000,000, with 50% to be contributed by each party. Upon the establishment of the JV Company, the JV Company will acquire certain assets from Kandi and Geely Auto in order for the JV Company to process the necessary properties, assets and technologies to conduct the EV business.

On February 27, 2013, Kandi Vehicles entered into an Assets Purchase Agreement (the "Purchase Agreement") with Zhejiang New Energy Vehicle System Co., Ltd., a limited liability company in China ("New Energy"). The Purchase Agreement finalized the arrangements the Company negotiated in 2012 for the purchase by Kandi Vehicles of certain electric vehicle ("EV") operating assets of New Energy, including a pressing assembly line, a welding assembly line, a coating assembly line, a general assembly line and related equipment, facilities, building and land use rights (the "Purchased Assets") for a total cash price of RMB 272,767,553 (approximately \$43,296,437). The price was based upon a third-party appraisal prepared by Jinhua Jinehen Assets Appraisal Co., Ltd. In connection with the initiation of exclusive negotiations with New Energy and pursuant to a letter of intent ("LOI") between the parties on November 20, 2012, the Company, as of December 31, 2012, delivered RMB 154,100,000 (approximately \$24,397,967) as a refundable deposit. Pursuant to the LOI, the deposit was to be applied to the purchase price and to be returned to Kandi Vehicles within 5 days upon the termination of negotiations if the parties could not reach a final agreement. Pursuant to the Purchase Agreement, the remainder of the purchase price will be delivered within one month of the completion of the transfer by New Energy of titles to and ownership of the Purchased Assets. Under the Purchase Agreement, New Energy is to complete the transfer of ownership and title (for the land, land use rights and operating and other assets) within three months of the signing of the Purchase Agreement. The Purchase Agreement contains customary representations and warranties and pre- and post-closing covenants of each party. Breaches of the representations and warranties are subject to customary indemnification provisions.

On March 13, 2013, the Company's wholly owned subsidiary, Kandi Vehicles, established Kandi Electric Vehicles (Changxing) Co., Ltd. ("Kandi Changxing") in the Changxing (National) Economic and Technological Development Zone to meet the requirements of the previously announced cooperation agreement with Geely Auto. The newly established company is a wholly owned subsidiary of Kandi Vehicles that will specialize in EV production. Kandi Changxing has been formed with the assets acquired by Kandi Vehicles in connection with its recent purchase from Zhejiang New Energy Vehicle Systems Co., Ltd., as well as certain molds and properties originally owned by Kandi Vehicles. Kandi Changxing is expected to begin production on March 29, 2013.

As set forth on the Company's Current Report on Form 8-K, filed March 25, 2013, on March 22, 2013, Kandi Vehicles entered into the Joint Venture Agreement of Establishment of Zhejiang Kandi Electric Vehicles Co., Ltd. with Shanghai Maple Guorun Automobile Co., Ltd., a 99% owned subsidiary of Geely Automobile Holdings Ltd. which is listed with Hong Kong Exchanges and Clearing Limited.

Sales and Distribution

Kandi's sales are made through the Company's own sales force and trading companies, which distribute Kandi's products to local and international customers.

Sources of Supply

Kandi manufactures the major components of its vehicles by itself. Other components and parts needed are purchased from expertise suppliers and specialized manufacturers. Kandi does not have and does not anticipate having any difficulty in obtaining its required materials from suppliers; in reaching this determination, we considered our current contracts and our current satisfactory business relationship with our suppliers.

Competition

The global off-road vehicle market and new EV market are both highly competitive. Competition in such markets is based upon a number of factors, including price, quality, reliability, styling, product features and warranties. With respect to the Chinese domestic pure EV industry, many of our competitors have financial and marketing resources that are substantially greater than Kandi; however, we believe we are one of the industry leaders.

Employees

As of December 31, 2012, Kandi had a total of 516 full time employees. None of our employees are represented by any collective bargaining agreements.

Environmental and Safety Regulation

Emissions

The United States Environmental Protection Agency (EPA) and the California Air Resources Board (CARB) have adopted emissions regulations applicable to Kandi s products. CARB has emissions regulations for ATVs and off-road vehicles which the Company already meets. In October 2002, the EPA established new corporate average emission standards effective for model years 2006 through 2012 for non-road recreational vehicles, including ATVs and off-road vehicles.

Kandi s motorcycles are also subject to EPA and CARB emission standards. Kandi believes that its motorcycles comply with these standards. CARB regulations, adopted by the EPA in January 2004, required additional motorcycle emission reductions in model year 2008, which the Company met.

Kandi s products are also subject to international laws and regulations related to emissions in places where it sells its products outside the United States. Europe currently regulates emissions from certain of the Company s ATV-based products, motorcycles, and super-mini-cars and the Company meets these requirements. Canada s emission regulations for motorcycles are similar to those in the U.S. In December 2006, Canada proposed a new regulation that would essentially adopt the U.S. emission standards for ATVs and off-road vehicles. These regulations became effective in 2009 and the Company meets this standard.

Kandi believes that its off-road vehicles and super-mini-cars comply with applicable emission standards and related regulations in the United States and internationally. Kandi is unable to predict the ultimate impact of standards adopted in the future or proposed regulations on Kandi and its business.

Use regulation

State and federal laws and regulations have been promulgated or are under consideration relating to the use or manner of use of Kandi s products. Some states and localities have adopted, or are considering the adoption of, legislation and local ordinances which restrict the use of ATVs and off-road vehicles to specified hours and locations. The federal government also has restricted the use of ATVs and off-road vehicles in some national parks and federal lands. In several instances this restriction has been a ban on the recreational use of these vehicles. Kandi is unable to predict the outcome of such actions or the possible effect on its business. Kandi believes that its business would be no more adversely affected than those of its competitors by the adoption of any pending laws or regulations.

Product Safety and Regulation

Safety Regulation

The federal government and individual states have promulgated or are considering promulgating laws and regulations relating to the use and safety of Kandi's products. The federal government is the primary regulator of product safety. The Consumer Product Safety Commission (CPSC) has federal oversight over product safety issues related to ATVs and off-road vehicles. The National Highway Transportation Safety Administration (NHTSA) has federal oversight over product safety issues related to on-road motorcycles.

In August 2008, the Consumer Product Safety Improvement Act (the Act) was passed. The Act includes a provision that requires all manufacturers and distributors who import into or distribute ATVs within the United States to comply with the ANSI/SVIA safety standards, which were previously voluntary. The Act also requires the same manufacturers and distributors to have ATV action plans filed with the CPSC that are substantially similar to the voluntary action plans that were previously in effect. Kandi currently complies with the ANSI/SVIA standard.

Kandi's motorcycles are subject to federal vehicle safety standards administered by NHTSA. Kandi's motorcycles are also subject to various state vehicle safety standards. Kandi believes that its motorcycles comply with safety standards relevant to motorcycles.

Kandi's products are also subject to international standards related to safety in places where it sells its products outside the United States. Kandi believes that its motorcycles and super-mini-cars comply with applicable safety standards in the United States and internationally.

Principal Executive Offices

Our principal executive office is located in the Jinhua City Industrial Zone in Jinhua, Zhejiang Province, PRC, 321016 and our telephone number (86-579) 82239856.

Item 1A. Risk Factors.

You should carefully consider the risks described below together with all of the other information included in this report before making an investment decision with regard to our securities. The statements contained in or incorporated into this annual report on Form 10-K that are not historic facts are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those set forth in or implied by forward-looking statements. If any of the following risks actually occurs, our business, financial condition or results of operations could be harmed. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Relating to Our Overall Business Operations

We may not be able to comply with all applicable government regulations.

We are subject to extensive governmental regulation by the central, regional and local authorities in the PRC, where our business operations take place. We believe that we are currently in substantial compliance with all laws and governmental regulations and that we have all material permits and licenses required for our operations. Nevertheless, we cannot assure investors that we will continue to be in substantial compliance with current laws and regulations, or that we will be able to comply with any future laws and regulations. To the extent that new regulations are adopted, we will be required to conform our activities in order to comply with such regulations. Failure to comply with applicable laws and regulations could subject us to civil remedies, including fines, injunctions, recalls or seizures, as well as potential criminal sanctions, which could have a material adverse effect on our business, operations and finances.

Compliance with environmental regulations can be expensive, and noncompliance with these regulations may result in adverse publicity and potentially significant monetary damages and fines.

Our business operations generate noise, waste water, and gaseous and other industrial wastes. We are required to comply with all national and local regulations regarding protection of the environment. We are in compliance with current environmental protection requirements and have all necessary environmental permits to conduct our business. However, if more stringent regulations are adopted in the future, the costs of compliance with these new regulations could be substantial. Additionally, if we fail to comply with present or future environmental regulations, we may be required to pay substantial fines, suspend production or cease operations. Any failure by us to control the use of, or to restrict adequately the discharge of, hazardous substances could subject us to potentially significant monetary damages and fines or suspensions to our business operations. Certain laws, ordinances and regulations could limit our ability to develop, use, or sell our products.

Our business depends substantially on the continuing efforts of our executive officers, and our business may be severely disrupted if we lose their services.

Our future success depends substantially on the continued services of our executive officers, especially our CEO and Chairman of the Board of Directors, Mr. Hu Xiaoming. We do not maintain key man life insurance on any of our executive officers. Although this possibility is low, if any of our executive officers are unable or unwilling to continue in their present positions, we may not be able to replace them readily, if at all. Therefore, our business may be severely disrupted, and we may incur additional expenses to recruit and retain new officers. In addition, if any of our executives joins a competitor or forms a competing company, we may lose some of our customers.

We may be subject to product liability claims, recalls or warranty claims, which could be expensive, damage our reputation and result in a diversion of management resources.

The Company may be subject to lawsuits resulting from injuries associated with the use of the vehicles that it sells. The Company may incur losses relating to these claims or the defense of these claims. There is a risk that claims or liabilities will exceed our insurance coverage. In addition, the Company may be unable to retain adequate liability insurance in the future.

The Company may also be required to participate in recalls involving our vehicles, if any prove to be defective, or we may voluntarily initiate a recall or make payments related to such claims as a result of various industry or business practices or the need to maintain good customer relationships. Such a recall would result in a diversion of resources. While we do maintain product liability insurance, we cannot assure you that it will be sufficient to cover all product liability claims, that such claims will not exceed our insurance coverage limits or that such insurance will continue to be available on commercially reasonable terms, if at all. Any product liability claim brought against us could have a material adverse effect on our results of operations.

As disclosed in a number of areas, including Item 3 of this Form 10-K, there are two lawsuits currently pending in state court in Ripley County, Missouri against the Company and its subsidiary, Kandi Vehicles, as well as other third parties, in connection with the death of two individuals who died on March 3, 2006, while operating a go-cart that was allegedly manufactured by Kandi Vehicles. The Company intends to defend these cases vigorously and expects to prevail in this lawsuit since neither the Company nor its subsidiaries manufactured the subject vehicle in the accident; however, if the Company does not prevail, or resolve this lawsuit favorably, these lawsuits could have a material adverse effect on our results of operations.

General economic conditions may negatively impact our results.

The consumption of entertainment products, such as go-karts, and super-mini-cars depends on continued economic growth. Due to the European Debt Crisis and the slow global economy, the uncertainty of the current economic environment remains. Moderate or severe economic downturns or adverse conditions may negatively affect our operations. These conditions may be widespread or isolated to one or more geographic regions. A tightening of the labor markets in one or more geographic regions may result in fewer qualified applicants for job openings in our facilities. Higher wages, related labor costs and other increasing cost trends may negatively impact our results.

Government policies may negatively affect our result

The Company's EV products currently are mainly sold to Chinese domestic market, and EV industry is supported by the Chinese central and local governments. Therefore, our EV products performance is significantly affected by the policies adopted by Chinese central and local governments. Any significant adverse changes in the Chinese governments' supporting policies may negatively affect our results.

The audit report included in this annual report was prepared by auditors who are not inspected by the Public Company Accounting Oversight Board and, as a result, you are deprived of the benefits of such inspection

The independent registered public accounting firm that issues the audit reports included in our annual reports filed with the SEC, as auditors of companies that are traded publicly in the United States and a firm registered with the Public Company Accounting Oversight Board (United States), or the "PCAOB", is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditors are located in Hong Kong, a jurisdiction where the PCAOB is currently unable to conduct inspections, our auditors are not currently inspected by the PCAOB.

Inspections of other firms that the PCAOB has conducted outside the US have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China and Hong Kong prevents the PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections. Investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

Risks Relating to Our Vehicle Machinery Production Operations

We may be subject to significant potential liabilities as a result of defects in production and product liability.

Through our machinery production operations, we may be subject to claims of product defects and/or product liability arising in the ordinary course of business. These claims are common to the machinery production industry and can be costly.

With respect to certain general liability exposures, including manufacturing defect and product liability, interpretation of underlying current and future trends, assessment of claims and the related liability and reserve estimation process is highly subjective due to the complex nature of these exposures, with each exposure exhibiting unique circumstances. Furthermore, once claims are asserted for construction defects, it is difficult to determine the extent to which the assertion of these claims will expand geographically. We may not have sufficient funds available to cover any liability for damages, the cost of repairs, and/or the expense of litigation surrounding such claims, and future claims may arise out of events or circumstances not covered by insurance and not subject to effective indemnification agreements with our subcontractors.

The vehicle machinery industry is highly competitive, and we are subject to risks relating to competition that may adversely affect our performance.

The vehicle machinery industry is highly competitive, and our continued success depends upon our ability to compete effectively in markets that contain numerous competitors, some of which have significantly greater financial, marketing and other resources than we have. Competition may reduce our pricing structures, potentially causing us to lower our prices, which may adversely impact our profits. New or existing competition that uses a business model that is different from our business model may put pressure on us to change our model so that we can remain competitive.

Our high concentration of sales to relatively few customers may result in significant uncollectible accounts receivable exposure, which may adversely impact our liquidity, business, results of operations and financial condition.

As of December 31, 2012, our top five customers, in the aggregate, accounted for 83% and 86%, respectively, of our sales and accounts receivable. Due to the concentration of sales to relatively few customers, we face credit exposure from our customers and may experience uncollectible receivables from these customers should they face financial difficulties. If these customers fail to pay their accounts receivable, file for bankruptcy or significantly reduce their purchases of our programming, it would have an adverse effect on our business, financial condition, results of operations, and liquidity.

The Company's major customers for the year ended December 31, 2012 accounted for the following percentages of total sales and accounts receivable as follows:

Major Customers	Sales		Accounts Receivable	
	Twelve Months Ended December 31, 2012	Twelve Months Ended December 31, 2011	December 31, 2012	December 31, 2011
Company A	33%	8%	21%	2%
Company B	19%	-	42%	-
Company C	12%	25%	8%	56%
Company D	11%	20%	7%	19%
Company E	8%	-	8%	-

Our business is subject to the risk of supplier concentrations.

We depend on a limited number of suppliers for the sourcing of major components and parts and principal raw materials. As of December 31, 2012 and 2011, one supplier accounted for 32% and 61% of our purchases, respectively. As a result of this concentration in our supply chain, our business and operations would be negatively affected if any of our key suppliers were to experience significant disruption affecting the price, quality, availability or timely delivery of their products. The partial or complete loss of these suppliers, or a significant adverse change in our relationship with any of these suppliers, could result in lost revenue, added costs and distribution delays that could harm our business and customer relationships. In addition, concentration in our supply chain can exacerbate our exposure to risks associated with the termination by key suppliers of our distribution agreements or any adverse change in the terms of such agreements, which could have a negative impact on our revenues and profitability.

The Company's major suppliers for the twelve months ended December 31, 2012 accounted for the following percentage of total purchases and accounts payable as follows:

Major Suppliers	Purchases		Accounts Payable	
	Twelve Months Ended December 31, 2012	Twelve Months Ended December 31, 2011	December 31, 2012	December 31, 2011
Company F	32%	61%	4%	1%
Company G	26%	-	-	-
Company H	6%	-	1%	-
Company I	2%	-	1%	-
Company J	2%	-	1%	-

Risks Related to Doing Business in China

Changes in political and economic conditions may affect our business operations and profitability.

Since our business operations are primarily located in China, our business operations and financial position are subject, to a significant degree, to the economic, political and legal developments in China.

While the Chinese government has not halted its economic reform policy since 1978, any significant adverse changes in the social, political and economic conditions of China may fundamentally impact China's economic reform policies, and thus the Company's operations and profits may be adversely affected.

Change in tax laws and regulations in China may affect our business operations.

Various tax reform policies have been implemented in the PRC in recent years. However, there can be no assurance that the existing tax laws and regulations will not be revised or amended in the future.

Uncertainties with respect to the Chinese legal system could have a material adverse effect on us and may restrict the level of legal protections to foreign investors.

China's legal system is based on statutory law. Unlike the common law system, statutory law is based primarily on written statutes. Previous court decisions may be cited as persuasive authority but do not have a binding effect. Since 1979, the PRC government has been promulgating and amending the laws and regulations regarding economic matters, such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, since these laws and regulations are relatively new, and the PRC legal system continues to rapidly evolve, the interpretation of many laws, regulations and rules is not always uniform and enforcement of these laws, regulations and rules involves uncertainties, which may limit legal protections available to us.

In addition, any litigation in China may be protracted and may result in substantial costs and diversion of resources and management's attention. The legal system in China cannot provide investors with the same level of protection as in the U.S. The Company is governed by the law and regulations generally applicable to local enterprises in China. Many of these laws and regulations were recently introduced and remain experimental in nature and subject to changes and refinements. Interpretation, implementation and enforcement of the existing laws and regulations can be uncertain and unpredictable and therefore may restrict the legal protections of foreign investors.

Changes in Currency Conversion Policies in China may have a material adverse effect on us.

Renminbi (RMB) is still not a freely exchangeable currency. Since 1998, the State Administration of Foreign Exchange of China has promulgated a series of circulars and rules in order to enhance verification of foreign exchange payments under a Chinese entity's current account items, and has imposed strict requirements on borrowing and repayments of foreign exchange debts from and to foreign creditors under the capital account items and on the creation of foreign security in favor of foreign creditors.

This may complicate foreign exchange payments to foreign creditors under the current account items and thus will affect the ability to borrow under international commercial loans, the creation of foreign security, and the borrowing of RMB under guarantees in foreign currencies. Furthermore, the value of RMB may become subject to supply and demand, which could be largely impacted by international economic and political environments. Any fluctuations in the exchange rate of RMB could have an adverse effect on the operational and financial condition of the Company and its subsidiaries in China.

You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions based on United States or other foreign laws against us, our management or the experts named in the prospectus.

We conduct substantially all of our operations in China and substantially all of our assets are located in China. In addition, almost all of our senior executive officers reside in China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon our senior executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our PRC counsel has advised us that the PRC does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts.

Risks Relating to Ownership of Our Securities

Our stock price may be volatile, which may result in losses to our shareholders.

The stock markets have experienced significant price and trading volume fluctuations, and the market prices of companies listed on the NASDAQ Capital Market and NASDAQ Global Market have been volatile in the past and have experienced sharp share price and trading volume changes. Although our stock is listed on the NASDAQ Global Market, the trading price of our common stock is likely to be volatile and could fluctuate widely in response to many factors, including the following, some of which are beyond our control:

- variations in our operating results;
- changes in expectations of our future financial performance, including financial estimates by securities analysts and investors;
- changes in operating and stock price performance of other companies in our industry;
- additions or departures of key personnel; and
- future sales of our common stock.

Domestic and international stock markets often experience significant price and volume fluctuations. These fluctuations, as well as general economic and political conditions unrelated to our performance, may adversely affect the price of our common stock.

Mr. Hu, our CEO, President and Chairman of our Board of Directors is the beneficial owner of a substantial portion of our outstanding common stock, which may enable Mr. Hu to exert significant influence on corporate actions.

Excelvantage Group Limited controls approximately 37.9% of our outstanding shares of common stock as of December 31, 2012. On March 29, 2010, Hu Xiaoming, the Company's Chief Executive Officer, President and Chairman of the Board of Directors, became the sole stockholder of Excelvantage Group Limited. Excelvantage Group Limited has a substantial impact on matters requiring the vote of the shareholders, including the election of our directors and most corporate actions. This control could delay, defer or prevent others from initiating a potential merger, takeover or other change in our control, even if these actions would benefit our other shareholders and the Company. This control could adversely affect the voting and other rights of our other shareholders and could depress the market price of our common stock.

Our common shares may become thinly traded and you may be unable to sell your shares readily

We cannot predict the extent to which an active public market for trading our common stock will be sustained. Although our trading volume has increased gradually in recent years, our stock has historically been sporadic or thinly-traded, meaning that the number of persons interested in purchasing our common shares at any given time may be relatively small.

This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community who generate or influence sales volume. Even if we came to the attention of such persons, those persons tend to be risk-averse and may be reluctant to follow, purchase, or recommend the purchase of shares of an unproven company such as ours until such time as we become more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give you any assurance that a broader or more active public trading market for our common stock will develop or be sustained, or that current trading levels will be sustained.

The market price for our common stock is particularly volatile given our status as a relatively small company, which could lead to wide fluctuations in our share price. You may be unable to sell your common stock at or above your purchase price if at all, which may result in substantial losses to you.

Substantial exercise of warrants could adversely affect our stock price or our ability to raise additional financing in the public capital markets.

As of December 31, 2012, there were 2,274,851 shares of warrants outstanding. If the warrant holders exercise the warrants and sell a substantial number of shares of our Common Stock in the future, or if investors perceive that these sales may occur, the market price of our Common Stock could decline or market demand for our Common Stock could be sharply reduced. The exercise of warrants and subsequent sale of a substantial number of shares of our Common Stock could also adversely affect demand for, and the market price of, our Common Stock. Each of these transactions could adversely affect our ability to raise additional financing by issuing equity or equity-based securities in the public capital markets. As of the filing date of this Form 10-K, the number warrant shares outstanding as of December 31, 2012 (2,274,851) has been reduced, as a result of expiration or exercises to 1,210,912.

We do not anticipate paying any cash dividends to our common shareholders.

We presently do not anticipate that we will pay dividends on any of our common stock in the foreseeable future. If payment of dividends does occur at some point in the future, it would be contingent upon our revenues and earnings, if any, capital requirements, and general financial condition. The payment of any common stock dividends will be within the discretion of our Board of Directors. We presently intend to retain all earnings after paying the interest for the preferred stock, if any, to implement our business plan; accordingly, we do not anticipate the declaration of any dividends for common stock in the foreseeable future.

Fluctuation in the value of the RMB may have a material adverse effect on your investment.

The change in value of the RMB against the U.S. dollar, the Euro and other currencies is affected by changes in China's political and economic conditions, among other things. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the RMB against the U.S. dollar. As a portion of our costs and expenses is denominated in RMB, the revaluation in July 2005 and potential future revaluation has and could further increase our costs. In addition, any significant revaluation of the RMB may have a material adverse effect on our financial condition. For example, to the extent that we need to convert U.S. dollars we receive from financings into RMB for our operations, appreciation of the RMB against the U.S. dollar would have an adverse effect on the RMB amount we receive from the conversion. Conversely, if we decide to convert our RMB into U.S. dollars for the purpose of making payments for business purposes, appreciation of the U.S. dollar against the RMB would have a negative effect on the U.S. dollar amount available to us.

We may be unable to maintain compliance with NASDAQ Marketplace Rules which could cause our common stock to be delisted from the NASDAQ Global Market. This could result in the lack of a market for our common stock, cause a decrease in the value of our common stock, and adversely affect our business, financial condition and results of operations.

Under the NASDAQ Marketplace Rules our common stock must maintain a minimum price of \$1.00 per share for continued inclusion on the NASDAQ Global Market. We cannot guarantee that our stock price will remain at or above \$1.00 per share and if the price again drops below \$1.00 per share, the stock could become subject to delisting. If our common stock is delisted, trading of the stock will most likely take place on an over-the-counter market established for unlisted securities. An investor is likely to find it less convenient to sell, or to obtain accurate quotations in seeking to buy, our common stock on an over-the-counter market, and many investors may not buy or sell our common stock due to difficulty in accessing over-the-counter markets, or due to policies preventing them from trading in securities not listed on a national exchange or other reasons. For these reasons and others, delisting would adversely affect the liquidity, trading volume and price of our common stock, causing the value of an investment in us to decrease and having an adverse effect on our business, financial condition and results of operations by limiting our ability to attract and retain qualified executives and employees and limiting our ability to raise capital.

Volatility in Our Common Share Price May Subject Us to Securities Litigation.

The market for our common stock is characterized by significant price volatility as compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. In the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may, in the future, be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management's attention and resources.

The Elimination of Monetary Liability Against our Directors, Officers and Employees under Delaware law and the Existence of Indemnification Rights of our Directors, Officers and Employees May Result in Substantial Expenditures by our Company and may Discourage Lawsuits Against our Directors, Officers and Employees.

Our articles of incorporation do not contain any specific provisions that eliminate the liability of our directors for monetary damages to our company and shareholders; however, we are prepared to give such indemnification to our directors and officers to the extent provided for by Delaware law. We may also have contractual indemnification obligations under our employment agreements with our officers. The foregoing indemnification obligations could result in our company incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which we may be unable to recoup. These provisions and resultant costs may also discourage our company from bringing a lawsuit against directors and officers for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our shareholders against our directors and officers even though such actions, if successful, might otherwise benefit our company and shareholders.

We may need additional capital, and the sale of additional shares or other equity securities could result in additional dilution to our shareholders.

In the future, we may require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities could result in dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

Our business is subject to changing regulations related to corporate governance and public disclosure that have increased both our costs and the risk of noncompliance.

Because our common stock is publicly traded, we are subject to certain rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC and NASDAQ, have issued requirements and regulations and continue to develop additional regulations and requirements in response to corporate scandals and laws enacted by Congress, most notably the Sarbanes-Oxley Act of 2002. Our efforts to comply with these regulations have resulted in, and are likely to continue resulting in, increased general and administrative expenses and diversion of management time and attention from revenue-generating activities to compliance activities. Because new and modified laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

All land in the PRC is owned by the government and its ownership cannot be sold or transferred by or to any individual or private entity. Instead, the government grants or allocates landholders a land use right. There are four methods to acquire land use rights:

- grant of the right to use land;
- assignment of the right to use land;
- lease of the right to use land; and
- allocated land use rights

In comparison with Western common law concepts, granted land use rights are similar to life estates and allocated land use rights are in some ways similar to leaseholds.

Granted land use rights are provided by the government in exchange for a grant fee, and carry the rights to pledge, mortgage, lease, and transfer within the term of the grant. Land is granted for a fixed term - generally 70 years for residential use, 50 years for industrial use, and 40 years for commercial and other use. The term is renewable in theory. Unlike the usual case in Western nations, granted land must be used for the specific purpose for which it was granted.

Allocated land use rights are generally provided by the government for an indefinite period (usually to state-owned entities) and cannot be pledged, mortgaged, leased, or transferred by the user. Furthermore, allocated land can be reclaimed by the government at any time. Allocated land use rights may be converted into granted land use rights upon the payment of a grant fee to the government.

Kandi has the following granted land use rights:

Location	Area (square meters)	Term and Expiration	Certificate No.
Zhejiang Jinhua Industrial Park	72900.90	Nov 13, 2002 - Nov 13, 2052	10-15-0-203-1
Zhejiang Jinhua Industrial Park	39490.64	Nov 13, 2002 - Nov 13, 2052	10-15-0-203-2
Zhejiang Jinhua Industrial Park	46650.70	Dec 30, 2003 - Dec 30, 2053	10-15-0-16
Zhejiang Jinhua Industrial Park	37515.00	Dec 30, 2003 - Dec 30, 2053	10-15-0-17
Zhejiang Jinhua Industrial Park	49162.00	Dec 30, 2003 - Dec 30, 2053	10-15-0-18
Zhejiang Jinhua Industrial Park	19309.00	Dec 07, 2009 - Dec 07, 2059	10-15-0-33
Zhejiang Qiaoxia Industrial Park	9405.00	Apr 03, 2001 - Apr 03, 2051	574-26-36

Item 3. Legal Proceedings.

There are two lawsuits currently pending in state court in Ripley County, Missouri against the Company and its subsidiary, Kandi Vehicles as well as other third parties, Kandi Investment Group and SunL Group, in connection with the death of two individuals who died on March 3, 2006, while operating a go-cart that was allegedly manufactured by Kandi Vehicles. Kandi Investment Group was a major shareholder of Kandi Vehicles but it transferred all its equity in Kandi Vehicles to Continental Development Limited in November 2006. Since then, Kandi Investment Group has been unrelated to the Company or its affiliates.

The cases were filed in 2009 and are identified as Elder vs. SunL Group and Griffen vs. SunL Group. In March 2010, the local trial court entered two default judgments, each in the amount of \$20,000,000, against our subsidiary, Kandi Vehicles as well as other parties including Kandi Investment. A default judgment was not entered against the Company. The lawsuit and default judgments were not brought to the Company or Kandi Vehicles attention until May or June 2010; the Company was not served with the complaint or notified of the lawsuits and only learned of their existence and of the default judgments in the course of commercial discussions with another of the defendants in the cases. The Company and Kandi Vehicles have filed answers to the complaint denying any culpability. In addition, the Company requested that the court set aside the default judgments against Kandi Vehicles, a request granted, by the court, on February 28, 2011. On March 3, 2011, the plaintiffs subsequently appealed the court order vacating the default judgments; however, the plaintiffs have since voluntarily withdrawn their appeal.

The Company intends to defend these cases vigorously and expects to prevail in this lawsuit since the Company including its subsidiaries did not manufacture the subject vehicle in the accident. This case is set for trial in July 2013.

At the present time, we believe that resolving the above matters will not have a material adverse effect on our financial position, our results of operations, or our cash flows; however, these matters are subject to inherent uncertainties and our view of these matters may change in the future.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***Market Information*

Our common stock began trading on the NASDAQ Capital Market on March 18, 2008, and on January 10, 2011, our common stock began trading on NASDAQ Global Market. The following are the high and low prices for our common stock for each quarter from January 1, 2010 to December 31, 2012.

	HIGH	LOW
FISCAL 2012		
Fourth Quarter (through December 31, 2012)	\$ 4.69	\$ 3.52
Third Quarter (through September 30, 2012)	\$ 5.13	\$ 3.00
Second Quarter (through June 30, 2012)	\$ 3.74	\$ 2.33
First Quarter (through March 31, 2012)	\$ 3.98	\$ 2.95
FISCAL 2011		
Fourth Quarter (through December 31, 2011)	\$ 4.19	\$ 1.88
Third Quarter (through September 30, 2011)	\$ 3.30	\$ 1.71
Second Quarter (through June 30, 2011)	\$ 3.23	\$ 1.68
First Quarter (through March 31, 2011)	\$ 5.37	\$ 2.86
FISCAL 2010		
Fourth Quarter (through December 31, 2010)	\$ 7.25	\$ 4.10
Third Quarter (through September 30, 2010)	\$ 4.45	\$ 2.90
Second Quarter (through June 30, 2010)	\$ 5.19	\$ 2.75
First Quarter (through March 31, 2010)	\$ 6.75	\$ 3.24

Holder of Common Stock

As of December 31, 2012, there were 23 shareholders of record of our common stock.

Dividends

We have never paid a dividend on our common stock. At present, we intend to retain any earnings for use in our business and do not anticipate paying cash dividends in the foreseeable future.

Item 6. Selected Financial Data.

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

The following discussion should be read in conjunction with the information contained in the consolidated financial statements of the Company and the notes thereto appearing elsewhere herein. Readers should carefully review the risk factors disclosed in this Form 10-K and other documents filed by the Company with the SEC.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This section should be read together with the Summary of Significant Accounting Policies in the attached consolidated financial statements included in this report.

Estimates affecting accounts receivable and inventories

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect our reporting of assets and liabilities (and contingent assets and liabilities). These estimates are particularly significant where they affect the reported net realizable value of the Company's accounts receivable and inventories.

Accounts receivable are recognized and carried at net realizable value. An allowance for doubtful accounts will be recorded in the period when a loss is probable based on an assessment of specific evidence indicating troubled collection, historical experience, accounts aging, ongoing business relation and other factors. Accounts are written off after exhaustive efforts at collection. If accounts receivable are to be provided for, or written off, they would be recognized in the consolidated statement of operations within operating expenses. At December 31, 2012 and 2011, the Company has an allowance for doubtful accounts of \$0 and \$0 respectively, as per the management's judgment based on their best knowledge.

Inventory is stated at the lower of cost, determined on a weighted average basis, or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale. When inventories are sold, their carrying amount is charged to expense in the year in which the revenue is recognized. Write-downs for declines in net realizable value or for losses of inventories are recognized as an expense in the year the impairment or loss occurs. There was a \$56,248 decline in net realizable value of inventory for the year ended of December 31, 2012 due to our reserve for slow moving inventory.

While the Company currently believes that there is little likelihood that actual results will differ materially from these current estimates, if customer demand for our products decreases significantly in the near future, or if the financial condition of our customers deteriorates in the near future, the Company could realize significant write downs for slow-moving inventories or uncollectible accounts receivable.

Policy affecting recognition of revenue

Among the most important accounting policies affecting our consolidated financial statements is our policy of recognizing revenue. Revenues represent the invoiced value of goods sold, recognized upon the shipment of goods to customers, and are recognized when all of the following criteria are met:

1. Persuasive evidence of an arrangement exists;
2. Delivery has occurred or services have been rendered;
3. The seller's price to the buyer is fixed or determinable; and
4. Collectability is reasonably assured.

Policy affecting options, warrants and convertible notes

The Company's stock option cost is recorded in accordance with ASC 718 and ASC 505.

The fair value of stock options is estimated using the Black-Scholes-Merton model. The Company's expected volatility assumption is based on the historical volatility of the Company's stock. The expected life assumption is primarily based on the expiration date of the option. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Stock option expense recognized is based on awards expected to vest. There were no estimated forfeitures. ASC standards require forfeitures to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates.

The Company's warrant costs are recorded in liabilities and equities, respectively, in accordance with ASC 480, ASC 505 and ASC 815.

The Company estimates the fair value of warrants that are classified as a liability using a Black-Scholes-Merton model. The Company's expected volatility assumption is based on the historical volatility of the Company's stock. The expected life assumption is primarily based on the expiration date of the warrant. The risk-free interest rate for the expected term of the warrant is based on the U.S. Treasury yield curve in effect at the time of measurement. Warrants that are freestanding derivatives and classified as liabilities on the balance sheet are measured at fair value on each reporting date, with decreases in fair value recognized in earnings and increases in fair values recognized in expenses.

For those warrants that are not considered derivatives under ASC 815, the Company estimates that the fair value of equity based warrants using the Black-Scholes-Merton model. The Company's expected volatility assumption is based on the historical volatility of the Company's stock. The expected life assumption is primarily based on the expiration date of the warrant. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

In accordance with ASC 815, the conversion feature of the Convertible Notes is separated from the debt instrument and accounted for separately as a derivative instrument. On the date the Convertible Notes are issued, the conversion feature was recorded as a liability at its fair value, and future decreases in fair value are recognized in earnings while increases in fair values are recognized in expenses. The Company used the Black-Scholes-Merton option-pricing model to obtain the fair value of the conversion feature. The Company's expected volatility assumption is based on the historical volatility of the Company's stock. The expected life assumption is primarily based on the expiration date of the conversion features. The risk-free interest rate for the expected term of the conversion features is based on the U.S. Treasury yield curve in effect at the time of measurement.

RECENT ACCOUNTING PRONOUNCEMENTS

Recent Accounting Pronouncements

In July 2012, FASB has issued Accounting Standards Update (ASU) No. 2012-02, Intangibles--Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles--Goodwill and Other, General Intangibles Other than Goodwill. Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not expect the adoption of 2012-02 to have a material effect on its operating results or financial position.

In August 2012, FASB issued Accounting Standards Update (ASU) No. 2012-03, Technical Amendments and Corrections to SEC Sections. This ASU amended various SEC paragraphs pursuant to SAB 114, SEC Release No. 33-9250, and ASU 2010-22, which amend or rescind portions of certain SAB Topics. The adoption of 2012-03 did not have a material effect on the Company's operating results or financial position.

In October 2012, FASB has issued Accounting Standards Update (ASU) No. 2012-04, Technical Corrections and Improvements. This ASU make technical corrections, clarifications, and limited-scope improvements to various Topics throughout the Codification. The amendments in this ASU that will not have transition guidance will be effective upon issuance for both public entities and nonpublic entities. For public entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2012. For nonpublic entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2013. The Company does not expect the adoption of 2012-02 to have a material effect on its operating results or financial position.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company's financial statements upon adoption.

RESULTS OF OPERATIONS – YEAR ENDED DECEMBER 31, 2012 AS COMPARED TO YEAR ENDED DECEMBER 31, 2011

The following table sets forth the amounts and the percentage relationship to revenues of certain items in our consolidated statements of income for the years ended December 31, 2012 and 2011:

**For The Years Ended
December 31, 2012 and 2011**