CHINA RECYCLING ENERGY CORP
Form 10-Q
August 16, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from to

Commission File No. 000-12536

China Recycling Energy Corporation
(Exact Name of Registrant as Specified in Its Charter)

Nevada	90-0093373
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12/F, Tower A
Chang An International Building
No. 88 Nan Guan Zheng Jie
Xi'an City, Shaanxi Province, China
(Address of Principal Executive Offices, Zip Code)

Registrant's Telephone Number, Including Area Code: + 86-29-8769-1097

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation 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 o No o

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 o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company x

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

Yes o No x

The number of shares outstanding of the registrant’s Common Stock, as of June 30, 2010 was 38,778,035.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
CURRENT ASSETS		
Cash & cash equivalents	$ 5,089,700	$ 1,111,943
Restricted cash	1,671,354	1,461,659
Investment in sales type leases, net	5,861,246	4,396,395
Interest receivable on sales type leases	770,178	437,626
Prepaid expenses	167,310	445,458
Other receivables	206,819	184,355
VAT receivables - current	673,979	383,027
Total current assets	14,440,586	8,420,463
NON-CURRENT ASSETS		
VAT receivables - noncurrent	1,617,203	957,567
Investment in sales type leases, net	77,210,405	48,147,738
Property and equipment, net	204,606	97,311
Construction in progress	46,136,422	34,858,845
Total non-current assets	125,168,636	84,061,461
TOTAL ASSETS	$ 139,609,222	$ 92,481,924
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 5,602,415	$ 3,583,219
Notes payable - bank acceptances	2,076,308	1,461,659
Interest payable	1,363,584	-
Taxes payable	1,100,159	681,707
Accrued liabilities and other payables	2,632,080	2,785,796
Advance from related parties, net	2,503,578	468,475
Convertible note, net of discount due to beneficial conversion feature	3,564,348	-
Accrued interest on short term convertible note	64,050	-
Deferred tax liability-current	71,833	148,193
Loan payable - current	1,325,304	-
Total current liabilities	20,303,659	9,129,049

NONCURRENT LIABILITIES		
Deferred tax liability, net	4,695,937	2,762,115
Convertible notes	3,000,000	8,000,000
Accrued interest on long term convertible notes	285,335	353,024
Loans payable	40,222,944	25,570,429
Total noncurrent liabilities	48,204,216	36,685,568
Total liabilities	68,507,875	45,814,617
SHARES TO BE ISSUED	11,780,471	-
CONTINGENCIES AND COMMITMENTS		
STOCKHOLDERS' EQUITY		
Common stock, $0.001 par value; 100,000,000 shares authorized, 38,778,035 shares issued and outstanding as of June 30, 2010 and December 31, 2009, respectively	38,779	38,779
Additional paid in capital	42,042,866	38,319,163
Statutory reserve	3,770,192	2,497,724
Accumulated other comprehensive income	4,053,438	3,709,490
Retained earnings	7,393,961	1,485,914
Total Company stockholders' equity	57,299,236	46,051,070
Noncontrolling interest	2,021,640	616,237
Total equity	59,320,876	46,667,307
TOTAL LIABILITIES AND EQUITY	$ 139,609,222	$ 92,481,924

The accompanying notes are an integral part of these consolidated financial statements.

CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30, (UNAUDITED)		THREE MONTHS ENDED JUNE 30, (UNAUDITED)	
	2010	2009	2010	2009
Revenue				
Sales of systems	$ 31,921,309	$ 9,513,077	$ 21,795,873	$ 9,513,077
Contingent rental income	742,638	-	742,638	-
Rental income from operating lease	-	5,946,892	-	1,623,999
Total revenue	32,663,947	15,459,969	22,538,511	11,137,076
Cost of sales				
Cost of systems	24,600,160	7,317,751	16,801,915	7,317,751
Rental expense	-	4,148,572	-	1,126,899
Total cost of sales	24,600,160	11,466,323	16,801,915	8,444,650
Gross profit	8,063,787	3,993,646	5,736,596	2,692,426
Interest income on sales-type leases	6,418,263	2,333,472	3,323,695	1,134,941
Total operating income	14,482,050	6,327,118	9,060,291	3,827,367
Operating expenses				
General and administrative expenses	2,746,173	1,355,741	1,386,476	560,303
Total operating expenses	2,746,173	1,355,741	1,386,476	560,303
Income from operations	11,735,877	4,971,377	7,673,815	3,267,064
Non-operating income (expenses)				
Interest income	21,434	-	(37,705)	-
Interest expense	(1,188,449)	(433,768)	(737,075)	(375,549)
Other income	(3,568)	(5,153)	92,691	(3,059)
Total non-operating expenses, net	(1,170,583)	(438,921)	(682,089)	(378,608)
Income before income tax	10,565,294	4,532,456	6,991,726	2,888,456
Income tax expense (benefit)	2,898,043	225,151	1,861,277	(342,960)
Net income from operations	7,667,251	4,307,305	5,130,449	3,231,416
Less: Income (loss) attributable to noncontrolling interest	486,573	(3,158)	92,132	(3,198)
Net income attributable to China Recycling Energy Corp	7,180,678	4,310,463	5,038,317	3,234,614

Other comprehensive item								
Foreign currency translation (gain) loss attributable to China Recycling Energy Corp		343,948		(1,092)		385,866		28,803
Comprehensive income attributable to China Recycling Energy Corp	$	7,524,626	$	4,309,371	$	5,424,183	$	3,263,417
Comprehensive income attributable to noncontrolling interest	$	509,913	$	-	$	112,927	$	-
Basic weighted average shares outstanding		38,778,035		37,348,071		38,778,035		38,260,905
Diluted weighted average shares outstanding *		48,886,504		43,511,301		48,754,609		44,600,370
Basic net earnings per share	$	0.19	$	0.12	$	0.13	$	0.08
Diluted net earnings per share *	$	0.15	$	0.10	$	0.10	$	0.07

The accompanying notes are an integral part of these consolidated financial statements.

CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30, 2010	SIX MONTHS ENDED JUNE 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Income including noncontrolling interest	$ 7,667,251	$ 4,307,305
Adjustments to reconcile income including noncontrolling interest to net cash provided by operating activities:		
Depreciation and amortization	25,323	15,018
Amortization of discount related to conversion feature of convertible note	880,466	-
Stock options and warrants	1,407,547	442,191
Accrued interest on convertible notes	(3,639)	167,342
Changes in deferred tax	1,832,221	123,438
(Increase) decrease in current assets:		
Interest receivable on sales type lease	(258,972)	230,051
Prepaid expenses	279,184	3,899,203
VAT receivable and other receivables	(973,351)	(1,708)
Inventory	-	(299,355)
Increase (decrease) in current liabilities:		
Accounts payable	(1,362,890)	2,055,791
Taxes payable	412,624	(1,041,599)
Interest payable	1,356,732	-
Accrued liabilities and other payables	(166,058)	(906,267)
Net cash provided by operating activities	11,096,438	8,991,410
CASH FLOWS FROM INVESTING ACTIVITIES:		
Gross investment in sales type leases	(6,122,391)	(8,988,974)
Restricted cash	(200,653)	-
Acquisition of property & equipment	(131,547)	(14,297)
Construction in progress	(18,201,622)	(766,900)
Net cash used in investing activities	(24,656,213)	(9,770,171)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Insurance of common stock	-	2,000,000
Insurance of convertible notes	-	3,000,000
Cash contribution from noncontrolling interest	908,279	263,439
Proceeds from loans	15,757,780	2,927,101
Advance from (repayment to) related parties	850,408	(3,440)
Net cash provided by financing activities	17,516,467	8,187,100
EFFECT OF EXCHANGE RATE CHANGE ON CASH & CASH EQUIVALENTS	21,065	(13,479)
NET INCREASE IN CASH & CASH EQUIVALENTS	3,977,757	7,394,860

CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD		1,111,943		7,267,344
CASH & CASH EQUIVALENTS, END OF PERIOD	$	5,089,700	$	14,662,204
Supplemental Cash flow data:				
Income tax paid	$	945,165	$	1,074,560
Interest paid	$	201,635	$	261,858

The accompanying notes are an integral part of these consolidated financial statements.

CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010 (UNAUDITED) AND DECEMBER 31, 2009

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

China Recycling Energy Corporation (the "Company" or "CREG") (formerly China Digital Wireless, Inc.) was incorporated on May 8, 1980, under the laws of the State of Colorado. On September 6, 2001, the Company re-domiciled its state of incorporation from Colorado to Nevada. The Company, through its subsidiary, Shanghai TCH Energy Technology Co., Ltd ("Shanghai TCH"), sells and leases energy saving systems and equipment. On March 8, 2007, the Company changed its name to "China Recycling Energy Corporation".

On February 1, 2007, the Company's subsidiary, Shanghai TCH, conditionally entered into two top gas recovery turbine systems ("TRT") projects, each evidenced by a joint-operation agreement, with Xi'an Yingfeng Science and Technology Co., Ltd. ("Yingfeng") which were approved and made effective by our Board of Directors on April 8, 2007. TRT is an electricity generating system that utilizes the exhaust pressure and heat produced in the blast furnace of a steel mill to generate electricity. Yingfeng is a joint stock company registered in Xi'an, Shaanxi Province, Peoples Republic of China (the "PRC"), and engages in designing, installing, and operating TRT systems and sales of other renewable energy products.

Under the Joint-Operation Agreement, Shanghai TCH and Yingfeng jointly pursued a top gas recovery turbine project ("TRT Project") which was to design, construct, install and operate a TRT Project for Zhangzhi Iron and Steel Holdings Ltd. ("Zhangzhi"). This TRT Project was initiated by a Contract to Design and Construct TRT System ("Project Contract") entered by Yingfeng and Zhangzhi in 2006. Due to Yingfeng's lack of capital in pursuing this Project alone, Yingfeng sought Shanghai TCH's cooperation. Shanghai TCH provided various forms of investments and properties into this TRT Project including cash, hardware, software, equipment, major components and devices. In return, Shanghai TCH obtained all the rights, titles, benefits and interests that Yingfeng originally had under this Project Contract, including but not limited to the regular cash payments made by Zhangzhi and other property rights and interests. This project was completed and put into operation in February 2007.

Under another Joint-Operation Agreement, Shanghai TCH and Yingfeng jointly pursued another TRT project to design, construct, install and operate a TRT Project for Xingtai Iron and Steel Company, Ltd. ("Xingtai"). This Project was initiated by a Contract to Design and Construct TRT Project ("Project Contract") entered by Yingfeng and Xingtai on September 26, 2006. Due to Yingfeng's lack of capital in pursuing this Project alone, Yingfeng sought Shanghai TCH's cooperation. Shanghai TCH agreed to pursue this project with Yingfeng as a joint venture. Under the terms of the Joint-Operation Agreement, Shanghai TCH provided various investments and properties into the Project including cash, hardware, software, equipment, major components and devices. In return, Shanghai TCH obtained all the rights, titles, benefits and interests that Yingfeng originally had under this Project Contract, including but not limited to the regular cash payments made by Xingtai and other property rights and interests. This project was completed and put into operation in August 2007.

On October 31, 2007, Shanghai TCH entered an asset-transfer agreement with Yingfeng to transfer from Yingfeng to Shanghai TCH all electricity-generating related assets owned by Yingfeng. As the result, the contractual relationships between Shanghai TCH and Yingfeng under the TRT Project Joint-Operation Agreement on April 8, 2007 were terminated.

In November 2007, Shanghai TCH signed a cooperative agreement with Shengwei Group to build two sets of 12MW pure low temperature cement waste heat power generator systems ("CHPG") for Shengwei's two 2,500-tons-per-day cement manufacturing lines in Jin Yang and for a 5,000-tons-per-day cement manufacturing line in Tong Chuan.

Total investment in these projects was $12,593,000 (RMB 93,000,000). At the end of 2008, construction of the CHPG in Tong Chuan was completed at a cost of $6,191,000 (RMB 43,000,000) and put into operation. Under the original agreement, the ownership of the power generator system would belong to Shengwei from the date the system was put into service. Shanghai TCH is responsible for the daily maintenance and repair of the system, and charges Shengwei a monthly electricity fee based on the actual power generated by the system at 0.4116 RMB per KWH for an operating period of five years with the assurance from Shengwei of a properly functioning 5,000-tons-per-day cement manufacturing line and not less than 7,440 heat hours per year for the electricity generator system. Shengwei Group collateralized the cement manufacturing line in Tong Chuan to guarantee its obligations to provide the minimum electricity income from the power generator system under the agreement during the operating period. At the end of the five year operating period, Shanghai TCH will have no further obligations under the cooperative agreement. On May 20, 2009, Shanghai TCH entered into a supplementary agreement with Shengwei Group to amend the timing for title transfer to the end of the lease term. In addition, the supplementary agreement provided that Shanghai TCH will charge Shengwei based on actual power usage subject to a minimum of $0.31 million (RMB 2.1 million) per month during the operating period.

On June 29, 2009, construction of the CHPG in Jin Yang was completed at a cost of $7,318,000 (RMB 50,000,000) and put into operation. Shanghai TCH charges Shengwei a technical service fee of $336,600 (RMB 2,300,000) monthly for the sixty months of the lease term. Shengwei has the right to purchase the CHPG systems for $29,000 (RMB 200,000) at the end of the lease term. Shengwei is required to provide assurance of properly functioning 5,000-tons-per-day cement manufacturing lines and not less than 7,440 heat hours per year for the CHPG. Shengwei Group collateralized the cement manufacturing lines in Jin Yang to guarantee its obligations to provide the minimum electricity income from the power generator system under the agreement during the operating period. Effective July 1, 2009, Shanghai TCH outsourced the operation and maintenance of the CHPG systems in Tong Chuan and JinYang to a third party for $732,000 (RMB 5,000,000) per year.

On April 14, 2009, the Company incorporated a joint venture ("JV") with Erdos Metallurgy Co., Ltd. ("Erdos") to recycle waste heat from Erdos' metal refining plants to generate power and steam, which will then be sold back to Erdos. The name of the JV is Inner Mongolia Erdos TCH Energy Saving Development Co., Ltd ("Erdos TCH") with a term of 20 years, and registered capital of $2,635,000 (RMB 18,000,000). On September 30, 2009, Xi'an TCH Energy Technology Co., Ltd. ("Xi'an TCH") injected additional capital of $4.03 million (RMB 27,500,000). In November 2009, Xi'an TCH injected further capital of $5.05 million (RMB 34,500,000). As of December 31, 2009, total registered capital was $11.71 million (RMB 80,000,000), of which, $11.45 million (RMB 78,200,000) was from Xi'an TCH, and $0.26 million (RMB 1,800,000) was from Erdos. On April 14, 2010, total registered capital was raised to $17.55 million (RMB 120 million), of which, $16.37 million (RMB112 million) was contributed by Xi'an TCH and $1.18 million (RMB 8 million) was from Erdos. Total investment for the project is estimated at approximately $74 million (RMB 500 million) with an initial investment of $17.55 million (RMB 120,000,000). Erdos contributed 10% of the total investment of the project, and Xi'an TCH contributed 90%. According to Xi'an TCH and Erdos' agreement on profit distribution, Xi'an TCH and Erdos will receive 80% and 20% of the profit from the JV, respectively, until Xi'an TCH has received a complete return on its investment. Xi'an TCH and Erdos will then receive 60% and 40% of the profit from the JV, respectively. The profits to be distributed will be computed based on Chinese generally accepted accounting principles. The main difference between US GAAP (Generally Accepted Accounting Principles) and Chinese GAAP with regards to Erdos is that Erdos is treated as a sales-type lease under US GAAP and as an operating lease under Chinese GAAP. When the term of the JV expires, Xi'an TCH will transfer its equity in the JV to Erdos at no additional cost.

On April 18, 2009, Erdos TCH signed a Cooperation Agreement with Erdos to recycle heat from groups of furnaces of Erdos Metallurgy's metal refining plants to generate power and steam, which will then be sold back to Erdos Metallurgy. According to the contract, Erdos TCH will install a group of power generation projects with a total of 70MW power capacity, which may expand up to 120MW, and 30-ton steam per hour, with an estimated total investment in excess of $75 million (RMB 500 million). The construction of the projects was split into three phases, two power generation systems in Phase I with a total of 18MW power capacity, three power generation systems in Phase II with a total of 27MW power capacity and one power generation system in Phase III with 25MW power capacity.

At the end of 2009, Erdos TCH completed the first 9MW power station of Phase I of the project and put it into operation. Phase I includes two 9MW units for a combined 18MW power capacity. Pursuant to the Co-operation Agreement and the supplement agreements signed between Erdos and Erdos TCH, Erdos shall purchase all the electricity and steam to be generated from the JV's power generation projects. Erdos TCH leased the two 9 MW units to Erdos and will be responsible for the operation and maintenance of the units.

For each phase of the project, the lease term is 20 years starting from the date of completion of the phase. Erdos agreed to pay a fixed minimum of $0.22 million (RMB 1.5 million) per month for each 9MW capacity power generation unit. In addition Erdos will pay the actual amount if the sale of the electricity generated by each unit is more than $0.22 million (RMB 1.5 million) monthly.

Effective January 1, 2010, Erdos TCH outsourced to an independent third party the operation and maintenance of the first 9MW power generation project for $ 922,000 (RMB 6.27 million) per year. After 20 years, the units will be transferred to Erdos without charge. In March of 2010, the Company completed the second 9MW capacity power station and put it into operation. Effective April 1, 2010, Erdos TCH outsourced to an independent third party the operation and maintenance of the second 9MW power generation project for $922,000 (RMB 6.27 million) per year. After 20 years, the units will be transferred to Erdos without charge.

During 2008, the Company also leased two energy recycling power generation equipment systems under one-year, non-cancellable leases with the rents paid in full, which the Company subleased for higher rental income under one-year, non-cancellable leases. The Company did not renew its lease when it expired in April 2009, and as a result, the sublessee was unable to renew its lease with the Company.

On September 30, 2009, Xi'an TCH delivered to Shenmu County Jiujiang Trading Co., Ltd. ("Shenmu") a set of three 6 MW capacity Waste Gas Power Generation ("WGPG") power generating systems pursuant to a Cooperative Contract on Coke-oven Gas Power Generation Project (including its Supplementary Agreement) and a Gas Supply Contract for Coke-oven Gas Power Generation Project. The term of these contracts are for 10 years and provide that Xi'an TCH will recycle coke furnace gas from the coke-oven plant of Shenmu to generate power, which will be supplied back to Shenmu. Shenmu agrees to supply Xi'an TCH the coke-oven gas free of charge. Shenmu will pay the Company an annual "energy-saving service fee" of approximately $5.6 million in equal monthly installments for the life of the contracts, as well as such additional amount as may result from the supply of power to Shenmu in excess of 10.8 million kilowatt hours per month. The Company is responsible for operating the systems and will do so through an unrelated third party. Shenmu guarantees that monthly gas supply will not be lower than 21.6 million standard cubic meters. If gas supply is less, Shenmu agrees to pay Xi'an TCH energy-saving service fee described above or up to 10.8 million kilowatt-hours per month. Xi'an TCH maintains the ownership of the project for the term of the contracts, including the already completed investment, design, equipment, construction and installation as well as the operation and maintenance of the project. At the end of the 10-year term, ownership of the systems transfers to Shenmu at no charge. Shenmu gave a lien on its production line to guarantee its performance under the contracts. Shenmu's three major shareholders provide an unlimited joint liability guarantee to Xi'an TCH for Shenmu's performance under the contracts and the Yulin Huiyuan Group, an independent third party, provides a guarantee to Xi'an TCH for Shenmu's performance under the contracts.

On January 20, 2010, Xi'an TCH entered into a Technical Reconstruction Letter of Intent with Xueyi Dong ("Dong") a natural person with Chinese citizenship for Xi'an TCH reconstructing and transforming a Thermal Power Generation Systems owned by Dong into a 12MW Biomass Power Generation Systems ("Biomass Systems" or "BMPG") for approximately RMB 15 million (approximately $2.2 million), of which, RMB 7 million (approximately $1.03 million) was payable to Dong, and RMB 8 million (approximately $1.18 million) was payable to one of the Company's shareholder, who had previously paid that amount to Dong on behalf of the Company. These amounts are part of accounts payable and other payables respectively as at June 30, 2010.

After the successful transformation of the system, Xi'an TCH entered into a Biomass Power Generation Asset Transfer Agreement (the "Transfer Agreement") with Dong on June 29, 2010. Under the Transfer Agreement, Dong transferred the Biomass Systems to Xi'an TCH, and Xi'an TCH will pay Dong RMB 100,000, 000 (approximately $14,705,900) for the systems, including RMB 20,000,000 in cash and RMB 80,000,000 with equivalent shares of the Company's common stock. The stock price will be the same price as the Company's public offering price in the first public offering which occurs in 2010 or 2011 but in no circumstance less than $4 per share. The exchange rate between U.S. Dollar and Chinese RMB in connection with the stock issuance is 1:6.8. At June 30, 2010, the Company recorded accounts payable of RMB 20,000,000 (approximately $2.94 million), and shares to be issued of $11.78 million in connection with this transaction.

On June 29, 2010, Xi'an TCH entered into a Biomass Power Generation Project Lease Agreement with PuCheng XinHengYuan Biomass Power Generation Co., Ltd., ("XHY"). Under this lease agreement, Xi'an TCH leased this same set of 12MW biomass power generation systems to XHY at minimum RMB 1,900,000 per month (approximately $279,400) for 15 years. The leasing fee will increase proportionately with the biomass generated electricity fee in China during the term of this lease agreement.

The unaudited financial statements included herein were prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) that are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") omitted pursuant to such rules and regulations.

These financial statements should be read in conjunction with the audited financial statements and footnotes included in the Company's 2009 audited financial statements included in the Company's Annual Report on Form 10-K. The results for the six and three months ended June 30, 2010 are not necessarily indicative of the results to be expected for the full year ending on December 31, 2010.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The consolidated financial statements include the accounts of CREG and, its subsidiary, Sifang Holdings, its wholly owned subsidiaries, Huahong New Energy Technology Co., Ltd. ("Huahong") and Shanghai TCH, Shanghai TCH's subsidiaries Xi'an TCH Energy Tech Co., Ltd. ("Xi'an TCH") and Xingtai Huaxin Energy Tech Co., Ltd. ("Huaxin"), and Xi'an TCH's subsidiary Erdos TCH Energy Saving Development Co., Ltd, in which 90% of the investment will be from Xi'an TCH. Substantially all of the Company's revenues are derived from the operations of Shanghai TCH and its subsidiaries, which represent substantially all of the Company's consolidated assets and liabilities as of June 30, 2010 and December 31, 2009, respectively. All significant inter-company accounts and transactions were eliminated in consolidation.

Use of Estimates

In preparing these consolidated financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheets and revenues and expenses during the period reported. Actual results may differ from these estimates.

Revenue Recognition

Sales-type Leasing and Related Revenue Recognition

We construct and then lease waste energy recycling power generating projects to our customers. We usually transfer ownership of the waste energy recycling power generating projects to our customers at the end of each lease. Our investment in these projects is recorded as investment in sales-type leases in accordance with Statement of Financial Accounting Standards ("SFAS") No. 13, "Accounting for Leases" (codified in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 840) and its various amendments and interpretations. We finance our manufacture and construction of the waste energy recycling power generating projects and we finance our customers for the price of the projects. The sales and cost of sales are recognized at the time of sale or inception of the lease. The investment in sales-type leases consists of the sum of the total minimum lease payments receivable less unearned interest income and estimated executory cost. Unearned interest income is amortized to income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease. While a portion of revenue is recognized at the inception of the lease, the cash flow from the sales-type lease occurs over the course of the lease. Revenue is net of Value Added Tax.

Contingent Rental Income

The Company records income from actual electricity usage in addition to minimum lease payment of each project as contingent rental income in the period contingent rental income is earned. Contingent rent is not part of minimum lease payments.

Operating Leases

During 2008, we leased two energy recycling power generation equipment systems which were then subleased to two sublessees under one-year, non-cancellable leases with the rents paid in full. The leases and the subleases were not renewed when they expired in April 2009. These transactions were accounted for as operating leases. In an operating lease revenue is recognized as payments are received; the initial direct costs were deferred and amortized over the lease term on a straight-line basis, thus matching them against rental revenue.

Cash and Cash Equivalents

Cash and cash equivalents are carried at cost and represent cash on hand, demand deposits placed with banks or other financial institutions and all highly liquid investments with an original maturity of three months or less as of the purchase date of such investments.

Accounts Receivable and Concentration of Credit Risk

Accounts receivable are recorded at the invoiced amounts and do not bear interest. The Company extends unsecured credit to its customers in the ordinary course of business but mitigates the associated risks by performing credit checks and actively pursuing past due accounts. The Company does not require collateral or other security to support these receivables. The Company conducts periodic reviews of its clients' financial condition and customer payment practices to minimize collection risk on accounts receivable. As of June 30, 2010 and December 31, 2009, the Company had accounts receivable of $0.

An allowance for doubtful accounts is established and determined based on management's assessment of known requirements, aging of receivables, payment history, the customer's current credit worthiness and the economic environment. As of June 30, 2010 and December 31, 2009, the Company had accounts receivable allowance of $0.

The operations of the Company are located in the P.R.C.(the "People's Republic of China") Accordingly, the Company's business, financial condition, and results of operations may be influenced by the political, economic, and legal environments in the PRC, as well as by the general state of the PRC economy.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are expensed as incurred; additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method over the estimated lives as follows:

Building	20 years
Vehicle	2 - 5 years
Office and Other Equipment	2 - 5 years
Software	2 - 3 years

Impairment of Long-life Assets

In accordance with SFAS 144 (codified in FASB ASC Topic 360), the Company reviews its long-lived assets, including property, plant and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. If the total of the expected undiscounted future net cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and carrying amount of the asset. There was no impairment as of June 30, 2010 and December 31, 2009.

Cost of Sales

Cost of sales consists primarily of the direct material of the power generating system and expenses incurred directly for project construction for sales-type leasing; and rental expenses for two pieces of power generation equipment for the operating lease.

Income Taxes

The Company utilizes SFAS No. 109, "Accounting for Income Taxes," (codified in FASB ASC Topic 740), which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, ("FIN 48"), codified in FASB ASC Topic 740, on January 1, 2007. As a result of the implementation of FIN 48, the Company made a comprehensive review of its portfolio of tax positions in accordance with recognition standards established by FIN 48, and the Company recognized no material adjustments to liabilities or stockholders equity.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest associated with unrecognized tax benefits are classified as interest expense and penalties are classified in selling, general and administrative expenses in the statements of income. The adoption of FIN 48 did not have a material impact on the Company's financial statements. At June 30, 2010 and December 31, 2009, the Company did not take any uncertain positions that would necessitate recording of tax related liability.

Non-Controlling Interest

Effective January 1, 2009, the Company adopted FASB ASC Topic 810, “Consolidation,” which established new standards governing the accounting for and reporting of noncontrolling interests (NCIs) in partially owned consolidated subsidiaries and the loss of control of subsidiaries. Certain provisions of this standard indicate, among other things, that NCIs (previously referred to as minority interests) be treated as a separate component of equity, not as a liability (as was previously the case), that increases and decreases in the parent’s ownership interest that leave control intact be treated as equity transactions rather than as step acquisitions or dilution gains or losses, and that losses of a partially owned consolidated subsidiary be allocated to the NCI even when such allocation might result in a deficit balance.

The net income (loss) attributed to the NCI was separately designated in the accompanying statements of income and other comprehensive income. Losses attributable to the NCI in a subsidiary may exceed the NCI’s interests in the subsidiary’s equity. The excess attributable to the NCI is attributed to those interests. The NCI shall continue to be attributed its share of losses even if that attribution results in a deficit NCI balance.

Statement of Cash Flows

In accordance with SFAS No. 95, “Statement of Cash Flows” (codified in FASB ASC Topic 230), cash flows from the Company’s operations are calculated based upon the local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows may not necessarily agree with changes in the corresponding balances on the balance sheet. Cash flows from investing and financing activities exclude the cost of purchasing the Biomass System of $16.93 million (RMB 115,000,000) and transfer from construction in progress of approximately $7.14 million for a system that was sold for the Erdos Phase I project. Cash flows from operating activities includes conversion of trade accounts payable to notes payable of approximately $600,000 because the conversion of accounts payable to notes payable is merely an extension of credit terms by the vendors.

Fair Value of Financial Instruments

For certain of the Company’s financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, other receivables, accounts payable, accrued liabilities and short-term debt, the carrying amounts approximate their fair values due to their short maturities. Receivables on sales-type leases are based on interest rates implicit in the lease.

ASC Topic 820, “Fair Value Measurements and Disclosures,” requires disclosure of the fair value of financial instruments held by the Company. ASC Topic 825, “Financial Instruments,” defines fair value, and establishes a three-level valuation hierarchy for disclosures of fair value measurement that enhances disclosure requirements for fair value measures. The carrying amounts reported in the consolidated balance sheets for receivables and current liabilities each qualify as financial instruments and are a reasonable estimate of their fair values because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels of valuation hierarchy are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company analyzes all financial instruments with features of both liabilities and equity under ASC 480, “Distinguishing Liabilities from Equity,” and ASC 815.

As of June 30, 2010 and December 31, 2009, the Company did not identify any assets and liabilities that are required to be presented on the balance sheet at fair value.

Stock Based Compensation

The Company accounts for its stock-based compensation in accordance with SFAS No. 123R, "Share-Based Payment, an Amendment of FASB Statement No. 123" (codified in FASB ASC Topic 718). The Company recognizes in its statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees and non-employees.

Basic and Diluted Earnings per Share

Basic earnings per share ("EPS") is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed similar to basic net income per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted net earnings per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period. The following table presents a reconciliation of basic and diluted earnings per share for six and three months ended:

	Six Months Ended		Three Months Ended	
	2010	2009	2010	2009
Net income for common shares	$ 7,180,678	$ 4,310,463	$ 5,038,317	$ 3,234,614
Interest expense on convertible notes*	-	167,342	-	104,329
Net income for diluted shares	7,180,678	4,477,805	5,038,317	3,338,943
Weighted average shares outstanding - basic	38,778,035	37,348,071	38,778,035	38,260,905
Effect of dilutive securities:				
Convertible notes**	7,625,969	6,163,230	7,596,154	6,339,465
Options granted	2,357,500	-	2,264,454	-
Warrants granted	125,000	-	115,966	-
Weighted average shares outstanding – diluted	48,886,504	43,511,301	48,754,609	44,600,370
Earnings (loss) per share – basic	$ 0.19	$ 0.12	$	