

CHINA RECYCLING ENERGY CORP
Form 10-Q
May 15, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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 (I.R.S. Employer

incorporation or organization) 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 No

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 No

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

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

Yes No

The number of shares outstanding of the registrant's Common Stock, as of May 9, 2013 was 50,224,350.

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CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES**CONSOLIDATED BALANCE SHEETS****MARCH 31, 2013 AND DECEMBER 31, 2012**

| | 2013 (UNAUDITED) | 2012 |
|---|-----------------------|-----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash & equivalents | \$ 44,849,549 | \$45,004,304 |
| Restricted cash | 1,036,865 | 2,725,002 |
| Notes receivable | 638,070 | - |
| Accounts receivable | 55,921 | 81,819 |
| Current portion of investment in sales type leases, net | 11,029,700 | 10,389,028 |
| Interest receivable on sales type leases | 63,162 | 912,467 |
| Prepaid expenses | 53,467 | 49,581 |
| Other receivables | 200,297 | 121,109 |
| Advance to related party | - | 440,987 |
| Prepaid interest on trust loans | 818,325 | 816,164 |
| Prepaid loan fees - current | 81,354 | 81,139 |
| Total current assets | 58,826,710 | 60,621,600 |
| NON-CURRENT ASSETS | | |
| Prepaid loan fees - noncurrent | 183,046 | 202,848 |
| Investment in sales type leases, net | 129,639,111 | 118,021,435 |
| Long term deposit | 389,537 | 388,508 |
| Property and equipment, net | 61,589 | 68,305 |
| Construction in progress | 21,396,379 | 22,993,905 |
| Total non-current assets | 151,669,662 | 141,675,001 |
| TOTAL ASSETS | \$ 210,496,372 | \$ 202,296,601 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 6,589,158 | \$ 239,722 |
| Notes payable - bank acceptances | 1,595,176 | 3,659,216 |
| Taxes payable | 1,505,023 | 1,372,535 |
| Accrued liabilities and other payables | 1,808,605 | 1,534,829 |
| Advance from related parties | 40,751 | - |

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| | | |
|---|--------------------|--------------------|
| Deferred tax liability | 2,652,145 | 2,471,925 |
| Bank loans payable - current | 13,558,998 | 13,523,188 |
| Trust loans payable | 31,504,730 | 31,421,526 |
| Interest payable on trust loans | 1,295,745 | 317,962 |
| Convertible note | 3,766,694 | 3,766,694 |
| Accrued interest on convertible note | 563,112 | 383,929 |
| Current portion of long term payable | 1,321,309 | 1,292,185 |
| Total current liabilities | 66,201,446 | 59,983,711 |
| NONCURRENT LIABILITIES | | |
| Deferred tax liability, net | 7,161,882 | 6,565,618 |
| Refundable deposit from customers for systems leasing | 590,215 | 588,656 |
| Long term payable | 3,381,363 | 3,711,658 |
| Bank loans payable | 10,049,610 | 12,091,321 |
| Total noncurrent liabilities | 21,183,070 | 22,957,253 |
| Total liabilities | 87,384,516 | 82,940,964 |
| CONTINGENCIES AND COMMITMENTS | | |
| | - | - |
| STOCKHOLDERS' EQUITY | | |
| Common stock, \$0.001 par value; 100,000,000 shares authorized, 50,224,350 shares issued and outstanding as of March 31, 2013 and December 31, 2012 | 50,225 | 50,225 |
| Additional paid in capital | 58,501,642 | 58,501,642 |
| Statutory reserve | 8,185,866 | 7,766,002 |
| Accumulated other comprehensive income | 11,879,559 | 11,554,225 |
| Retained earnings | 39,985,433 | 37,107,107 |
| Total Company stockholders' equity | 118,602,725 | 114,979,201 |
| Noncontrolling interest | 4,509,131 | 4,376,436 |
| Total equity | 123,111,856 | 119,355,637 |
| TOTAL LIABILITIES AND EQUITY | \$ 210,496,372 | \$ 202,296,601 |

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

| | THREE MONTHS ENDED MARCH | |
|--|--------------------------|-------------|
| | 31, | |
| | 2013 | 2012 |
| Revenue | | |
| Sales of systems | \$ 14,079,796 | \$ - |
| Contingent rental income | 260,775 | 147,553 |
| Total revenue | 14,340,571 | 147,553 |
| Cost of sales | | |
| Cost of systems | 10,900,912 | 14,383 |
| Total cost of sales | 10,900,912 | 14,383 |
| Gross profit | 3,439,659 | 133,170 |
| Interest income on sales-type leases | 3,824,840 | 4,814,250 |
| Total operating income | 7,264,499 | 4,947,420 |
| Operating expenses | | |
| General and administrative | 1,082,446 | 779,555 |
| Income from operations | 6,182,053 | 4,167,865 |
| Non-operating income (expenses) | | |
| Interest income | 92,588 | 26,906 |
| Interest expense | (1,494,496) | (2,601,234) |
| Changes in fair value of conversion feature liability | - | 1,127,400 |
| Other expenses | (980) | (92,046) |
| Total non-operating expenses net | (1,402,888) | (1,538,974) |
| Income before income tax | 4,779,165 | 2,628,891 |
| Income tax expense | 1,360,054 | 487,392 |
| Income before noncontrolling interest | 3,419,111 | 2,141,499 |
| Less: Income attributable to noncontrolling interest | 120,921 | 118,934 |
| Net income attributable to China Recycling Energy Corp | 3,298,190 | 2,022,565 |

| | | |
|---|--------------|--------------|
| Other comprehensive items | | |
| Foreign currency translation gain attributable to China Recycling Energy Corp | 325,334 | 122,886 |
| Foreign currency translation gain attributable to noncontrolling interest | 11,774 | 5,019 |
| Comprehensive income attributable to China Recycling Energy Corp | \$ 3,623,524 | \$ 2,145,451 |
| Comprehensive income attributable to noncontrolling interest | \$ 132,695 | \$ 123,953 |
| Basic weighted average shares outstanding | 50,224,350 | 46,474,350 |
| Diluted weighted average shares outstanding * | 50,945,906 | 53,009,813 |
| Basic earnings per share | \$ 0.07 | \$ 0.04 |
| Diluted earnings per share * | \$ 0.07 | \$ 0.04 |

* Interest expense accrued on convertible notes is added back to net income for the computation of diluted EPS.

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

| | THREE MONTHS ENDED MARCH 31 | |
|---|-----------------------------|--------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Income including noncontrolling interest | \$ 3,419,111 | \$ 2,141,499 |
| Adjustments to reconcile income including noncontrolling interest to net cash provided by operating activities: | | |
| Changes in sales type leases receivables | (14,079,796 |) - |
| Depreciation and amortization | 11,305 | 14,210 |
| Amortization of prepaid loan fees | 20,307 | 20,214 |
| Amortization of discount related to conversion feature of convertible note | - | 583,650 |
| Changes in fair value of conversion feature liability | - | (1,127,400 |
| Stock options and warrants expenses | - | 25,784 |
| Changes in deferred tax | 751,402 | 227,293 |
| (Increase) decrease in current assets: | | |
| Interest receivable on sales type lease | 850,419 | 1,189,067 |
| Collection of principal on sales type leases | 2,179,702 | 2,296,217 |
| Prepaid expenses | (3,749 |) 470 |
| Account receivables | 26,074 | 5,744,801 |
| Other receivables | (78,746 |) 418,660 |
| Construction in progress | 1,655,880 | (15,835 |
| Increase (decrease) in current liabilities: | | |
| Accounts payable | 4,268,535 | (1,199,993 |
| Taxes payable | 128,657 | (1,615,487 |
| Interest payable | 975,447 | 1,071,156 |
| Accrued liabilities and other payables | 271,341 | 25,953 |
| Accrued interest on convertible notes | 179,183 | 238,362 |
| Net cash provided by operating activities | 575,072 | 10,038,621 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Changes of restricted cash | 1,692,761 | (475,632 |
| Acquisition of property & equipment | (4,420 |) (262 |
| Net cash provided by (used in) investing activities | 1,688,341 | (475,894 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Notes receivable - bank acceptances | (637,095 |) 15,854 |
| Notes payable - bank acceptances | - | 792,720 |
| Proceeds from loans | 4,778,211 | 4,756,318 |

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| | | | | |
|--|---------------|---|---------------|---|
| Repayment of loans | (6,848,770 |) | (951,264 |) |
| Convertible note | (313,941 |) | (288,888 |) |
| Advance from (to) related parties | 482,283 | | (2,407,334 |) |
| Net cash provided by (used in) financing activities | (2,539,312 |) | 1,917,406 | |
| EFFECT OF EXCHANGE RATE CHANGE ON CASH & EQUIVALENTS | 121,144 | | 38,619 | |
| NET INCREASE (DECREASE) IN CASH & EQUIVALENTS | (154,755 |) | 11,518,752 | |
| CASH & EQUIVALENTS, BEGINNING OF PERIOD | 45,004,304 | | 14,949,253 | |
| CASH & EQUIVALENTS, END OF PERIOD | \$ 44,849,549 | | \$ 26,468,005 | |
| Supplemental Cash flow data: | | | | |
| Income tax paid | \$ 481,732 | | \$ 1,824,958 | |
| Interest paid | \$ 513,574 | | \$ 556,805 | |

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CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 (UNAUDITED) AND DECEMBER 31, 2012

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

China Recycling Energy Corporation (the "Company" or "CREG") 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 to Nevada. The Company, through its subsidiaries, Shanghai TCH Energy Technology Co., Ltd ("Shanghai TCH") and Huahong New Energy Technology Co, Ltd (Huahong), provides energy saving solution and services, including selling and leasing energy saving systems and equipment to customers. On March 8, 2007, the Company changed its name to "China Recycling Energy Corporation" from "China Digital Wireless, Inc."

On February 1, 2007, the Company's subsidiary, Shanghai TCH, conditionally entered into two top gas recovery turbine systems (the "TRT") projects, each evidenced by a joint-operation agreement, with Xi'an Yingfeng Science and Technology Co., Ltd. (the "Yingfeng"). TRT is an electricity generating system that utilizes exhaust pressure and heat produced in the blast furnace of a steel mill to generate electricity.

Under these two Joint-Operation Agreements, Shanghai TCH and Yingfeng jointly pursued a top gas recovery turbine project (the "TRT Project") that was to design, construct, install and operate a TRT Project for Zhangzhi Iron and Steel Holdings Ltd. (the "Zhangzhi") and Xingtai Iron and Steel Company, Ltd. (the "Xingtai"), respectively. These two projects were completed and put into operation in February and August 2007, respectively. Xingtai power generation system reached maturity of the lease in January 2012, and the system was transferred to Xingtai.

On October 31, 2007, Shanghai TCH entered an asset-transfer agreement with Yingfeng. The terms and conditions of this agreement required the transfer of all electricity-generating related assets owned by Yingfeng to Shanghai TCH. As a 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 powered generator systems ("CHPG") for Shengwei's two 2,500-tons-per-day cement manufacturing lines in Jing Yang and for a 5,000-tons-per-day cement manufacturing line in Tong Chuan. At the end of 2008, construction of the CHPG in Tong Chuan was completed and put into operation. On June 29, 2009,

construction of the CHPG in Jing Yang was completed and put into operation.

On April 14, 2009, the Company incorporated a joint venture (the “JV”) with Erdos Metallurgy Co., Ltd. (the “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 (the “Erdos TCH”) with a term of 20 years. Total investment for the project is estimated at \$79 million (RMB 500 million) with an initial investment of \$17.55 million (RMB 120,000,000). As of March 31, 2013, Erdos had contributed 7% of the total investment of the project, and Xi’an TCH had contributed 93%. 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 receives the complete return of its investment. Xi’an TCH and Erdos will then receive 60% and 40% of the profit from the JV, respectively. When the JV expires, Xi’an TCH will transfer its equity in the JV to Erdos at no cost.

On April 18, 2009, Erdos TCH signed a Cooperation Agreement with Erdos to recycle heat from a variety 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. 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. In March of 2010, the Company completed the second 9MW capacity power station and put it into operation. 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.

On December 10, 2010, Erdos TCH entered into a supplementary agreement with Xi'an Huaxin Energy Tech Co., Ltd (the construction contractor) to change the Erdos Phase II project of four 9MW waste heat generation systems to three 9MW systems, and to move the fourth 9MW waste heat generation system into Phase III of the project; as a result of entering into this supplementary agreement, the construction costs decreased from \$37.4 million (RMB248 million) to \$28.1 million (RMB186 million) for Phase II. In the first quarter of 2011, the Company completed all three 9MW power stations of Phase II and put them into operation. On September 13, 2012, the Company terminated the Phase III power generation system construction due to termination of refining plant construction by Erdos as a result of changing business development strategy.

On September 30, 2009, Xi'an TCH delivered three 6MW capacity Waste Gas Power Generation ("WGPG") systems to Shenmu County Jiujiang Trading Co., Ltd. ("Shenmu") pursuant to a Cooperative Contract on Coke-oven Gas Power Generation Project (including its Supplementary Agreement) ("Cooperative Agreement") and a Gas Supply Contract for Coke-oven Gas Power Generation Project. The terms of these contracts are for 10 years, and state 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.

On December 31, 2011, Xi'an TCH entered into a Repurchase Agreement for the Coke-Oven Gas Power Generation Project (the "Repurchase Agreement") with Shenmu. Under the Repurchase Agreement, Shenmu will purchase the set of 18MW capacity power generating systems (the "Systems") from Xi'an TCH and pay outstanding energy saving service fees of \$3.08 million (RMB 19.44 million) to Xi'an TCH within three working days from the date of the Repurchase Agreement. Xi'an TCH will transfer the Systems to Shenmu for \$18.75 million (RMB 120 million) (the "Repurchase Price") to be paid in three installments within 180 days. In June 2012, the Company received the full payment of outstanding energy saving service fees and system repurchase price, and, as a result, ownership of the Systems was transferred to Shenmu and the Cooperative Contract was terminated.

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 System (the "Biomass Systems" or "BMPG") for \$2.2 million (RMB 15 million), which was paid by Xi'an TCH to Dong. After the transformation of the system, Xi'an TCH entered into a Biomass Power Generation Asset 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 was to pay Dong \$14,705,900 (RMB 100,000,000) for the systems, including RMB 20,000,000 in cash and RMB 80,000,000 in shares of the Company's common stock. The exchange rate between U.S. Dollar and Chinese RMB in connection with the stock issuance was 1:6.8. During 2011, the Company paid the cash portion and issued 2,941,176 shares of common stock for payment of

RMB 80,000,000 in shares; in connection with this transaction, the Company also recorded a gain of \$8.3 million as a result of the change in fair value of liability, which was marked to market.

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 a minimum of \$279,400 (RMB 1,900,000) per month for 15 years.

On September 30, 2010, Xi'an TCH delivered to Zhongbao Binhai Nickel Co., Ltd. ("Zhongbao") a 7MW capacity Waste Heat Power Generation ("WHPG") system, an integral part of the facilities designed to produce 80,000 tons of nickel-alloy per year according to the recovery and power generation of waste heat agreement with Zhongbao, a nickel-alloy manufacturing joint venture between Zhonggang and Shanghai Baoshan Steel Group established in June 2009. Total investment in this project was \$7.8 million (RMB 55 million). The waste heat agreement with Zhongbao has a term of nine years and provides that Xi'an TCH will recycle waste heat from the nickel-alloy rotary kilns of Zhongbao to generate power and steam, which will be supplied back to Zhongbao. In addition, Xi'an TCH is responsible for applying for the Clean Development Mechanism ("CDM") under the Kyoto Protocol. Net proceeds from any CDM credit will be distributed between Zhongbao and Xi'an TCH at 60% and 40%, respectively. As of March 31, 2013, Xi'an TCH had not yet commenced the CDM application process.