SMARTHEAT INC.
Form 10-Q
November 02, 2015

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, 2015

OR

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

Commission file number: 001-34246

SMARTHEAT INC.
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	98-0514768 (IRS Employer Identification No.)
A-1, 10, Street 7 Shenyang Economic and Technological Development Zone Shenyang, China (Address of principal executive offices)	110141 (Zip Code)

+86 (24) 2519-7699
(Registrant's telephone number, including area code)

Indicate by checkmark 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 last 90 days.

YES x 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 x

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," "non-accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (do not check if a smaller reporting company)	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 ¨ NO x

As of October 29, 2015 there were 6,783,399 shares of common stock outstanding.

SmartHeat Inc.

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EXPLANATORY NOTE

On May 11, 2015 the holders of 62.3% of our outstanding common stock authorized the sale of all of the remaining interests, constituting 100% of its ownership interests, in SmartHeat Taiyu (Shenyang) Energy; SmartHeat Siping Beifang Energy Technology Co., Ltd.; SmartHeat (Shenyang Energy Equipment) Co. Ltd.; Hohhot Ruicheng Technology Co., Ltd.; and Urumchi XinRui Technology Limited Liability Company. The sale was effective on December 31, 2014. The financial statements and description of our company refer to periods both prior and after the sale.

NOTE ABOUT FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which include, but are not limited to, statements concerning our projected revenues, expenses, gross profit and income, mix of revenue, demand for our products, the benefits and potential applications for our products, the need for additional capital, our ability to obtain and successfully perform additional new contract awards and the related funding and profitability of such awards, the competitive nature of our business and markets and product qualification requirements of our customers. These forward-looking statements are based on our current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by us. Words such as "anticipates," "expects," "intends," "plans," "predicts," "potential," "believes," "seeks," "hopes," "estimates," "should," "may," "will," "with variations of these words or similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. Such factors include, but are not limited to the following:

- our goals and strategies;
- our expansion plans;
- our future business development, financial conditions and results of operations;
- the expected growth of the market for PHE products, heat meters and heat pumps in our target markets;
- our expectations regarding demand for our products;
- our expectations regarding keeping and strengthening our relationships with key customers;
- our ability to stay abreast of market trends and technological advances;
- our ability to protect our intellectual property rights effectively and not infringe on the intellectual property rights of others;
- our ability to attract and retain quality employees;
- our ability to pursue strategic acquisitions and alliances;
- competition in our industry in China;

· general economic and business conditions in the regions in which we sell our products;

· relevant government policies and regulations relating to our industry; and

· market acceptance of our products.

Additionally, this report contains statistical data that we obtained from various publicly available government publications and industry-specific third party reports. Statistical data in these publications also include projections based on a number of assumptions. The markets for PHEs, PHE Units, heat meters and heat pumps may not grow at the rates projected by market data, or at all. The failure of these markets to grow at the projected rates may have a material adverse effect on our business and the market price of our common stock. In addition, the changing nature of our customers' industries results in uncertainties in any projections or estimates relating to the growth prospects or future condition of our markets. Furthermore, if any one or more of the assumptions underlying the market data is later found to be incorrect, actual results may differ from the projections based on these assumptions.

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Unless otherwise indicated, information in this report concerning economic conditions and our industry is based on information from independent industry analysts and publications, as well as our estimates. Except where otherwise noted, our estimates are derived from publicly available information released by third party sources, as well as data from our internal research, and are based on such data and our knowledge of our industry, which we believe to be reasonable. None of the market data from independent industry publications cited in this report was prepared on our or our affiliates' behalf.

Additional information on the various risks and uncertainties potentially affecting our operating results are discussed in this report and other documents we file with the Securities and Exchange Commission, or the SEC, or available upon written request to our corporate secretary at: A-1, 10, Street 7, Shenyang Economic and Technological Development Zone, Shenyang, China 110141. We undertake no obligation to revise or update publicly any forward-looking statements for any reason, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on these forward-looking statements.

As used in this report, "SmartHeat," "Company," "we," "our" and similar terms refer to SmartHeat Inc. and its subsidiaries, unless the context indicates otherwise.

Our functional currency is the US Dollar, or USD, while the functional currency of our subsidiaries in China are denominated in Chinese Yuan Renminbi, or RMB, the national currency of the People's Republic of China, which we refer to as the PRC or China, and the functional currency of our subsidiary in Germany is denominated in Euros, or EUR. The functional currencies of our foreign operations are translated into USD for balance sheet accounts using the current exchange rates in effect as of the balance sheet date and for revenue and expense accounts using the average exchange rate during the fiscal year. See Note 2 of the consolidated financial statements included herein.

Effective February 7, 2012, we implemented a one-for-ten reverse stock split of our common stock. Unless otherwise indicated, all share amounts and per share prices in this report were retroactively adjusted to reflect the effect of this reverse stock split. See Note 1 of the consolidated financial statements included herein.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2015 (Unaudited)	DECEMBER 31, 2014
ASSETS		
CURRENT ASSETS		
Cash and equivalents	$2,174,118	$13,682,624
Restricted cash	12,493	9,913,104
Accounts receivable, net	516,971	16,052,184
Retentions receivable, net	29,901	1,309,057
Advances to suppliers, net	47,395	2,417,949
Other receivables (net), prepayments and deposits	1,750,070	5,068,411
Inventories, net	5,425,394	49,349,195
Taxes receivable	9,116	325,252
Notes receivable - bank acceptances	-	2,271,131
Total current assets	9,965,458	100,388,907
NONCURRENT ASSETS		
Long term investment	-	29,540
Restricted cash	-	123,002
Property and equipment, net	1,058,268	1,995,520
Intangible assets, net	507,665	576,999
Construction in progress	-	84,533
Total noncurrent assets	1,565,933	2,809,594
TOTAL ASSETS	$11,531,391	$103,198,501
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$161,434	$7,384,756
Advances from customers	1,607,101	2,714,603
Taxes payable	52,563	196,246
Accrued liabilities and other payables	3,431,236	19,319,461
Notes payable - bank acceptances	-	1,401,530
Loans payable	-	25,111,702
Total current liabilities	5,252,334	56,128,298
CREDIT LINE PAYABLE	3,384,335	2,749,335

DEFERRED TAX LIABILITY	40,911	66,024
TOTAL LIABILITIES	8,677,580	58,943,657
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, $0.001 par value; 75,000,000 shares authorized, 6,783,399 shares issued and outstanding	6,783	6,783
Paid-in capital	103,924,009	87,500,456
Statutory reserve	780,682	5,389,057
Accumulated other comprehensive income	12,829,076	8,549,568
Accumulated deficit	(114,888,801)	(76,198,760)
Total Company stockholders' equity	2,651,749	25,247,104
NONCONTROLLING INTEREST	202,062	19,007,740
TOTAL EQUITY	2,853,811	44,254,844
TOTAL LIABILITIES AND EQUITY	$11,531,391	$103,198,501

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (Unaudited)

	SIX MONTHS ENDED JUNE 30,		THREE MONTHS ENDED JUNE 30,	
	2015	2014	2015	2014
Net sales	$1,460,767	$1,621,431	$683,589	$1,404,769
Cost of sales	3,021,400	1,813,585	1,151,501	1,535,813
Gross loss	(1,560,633)	(192,154)	(467,912)	(131,044)
Operating expenses				
Selling	818,269	790,000	452,877	429,900
General and administrative	1,315,054	2,210,463	222,443	1,014,985
Provision (Reversal of provision) for bad debts	929,909	(2,007,214)	1,004,606	277,856
Provision for advance to suppliers	-	2,320,822	-	8,803
Total operating expenses	3,063,232	3,314,071	1,679,926	1,731,544
Loss from operations	(4,623,865)	(3,506,225)	(2,147,838)	(1,862,588)
Non-operating income (expenses)				
Interest income	4,223	9,770	1,533	6,728
Interest expense	(171,973)	(85,153)	(91,554)	(49,924)
Financial expense	(50,580)	(48,336)	(19,689)	(28,916)
Other income, net	60,118	446,469	28,491	378,988
Total non-operating income (expenses), net	(158,212)	322,750	(81,219)	306,876
Loss before income tax	(4,782,077)	(3,183,475)	(2,229,057)	(1,555,712)
Income tax expense (benefit)	8,831	75,493	(14,527)	90,029
Loss from continuing operations	(4,790,908)	(3,258,968)	(2,214,530)	(1,645,741)
Cumulative foreign currency translation gain on disposed entities	11,915,632	-	-	-
Income (loss) from operations of discontinued entities, net of tax	-	(3,641,237)	-	8,296,056
Loss on disposal of discontinued entities, net of tax	(47,151,307)	-	-	-
Net income (loss) including noncontrolling interest	(40,026,583)	(6,900,205)	(2,214,530)	6,650,315
Less: loss attributable to noncontrolling interest from continuing operations	(16,424)	(30,089)	(7,295)	(134,376)
	-	(1,412,208)	-	3,344,189

Less: income (loss) attributable to noncontrolling interest from discontinued operations, net of tax				
Net income (loss) to SmartHeat Inc.	(40,010,159)	(5,457,908)	(2,207,235)	3,440,502
Other comprehensive item				
Foreign currency translation gain (loss) attributable to discontinued operations	-	(514,919)	-	37,916
Foreign currency translation gain (loss) attributable to SmartHeat Inc.	(570,224)	6,111	73,039	(133,983)
Foreign currency translation gain (loss) attributable to noncontrolling interest	152	(2,091)	957	66
Comprehensive income (loss) attributable to SmartHeat Inc.	$(40,580,383)	$(5,966,716)	$(2,134,196)	$3,344,435
Comprehensive income (loss) attributable to noncontrolling interest	$(16,272)	$(1,444,388)	$(6,338)	$3,209,879
Basic and diluted weighted average shares outstanding	6,783,399	6,364,338	6,783,399	6,579,003
Basic and diluted loss per share from continuing operations	$(0.70)	$(0.51)	$(0.33)	$(0.23)
Basic and diluted earning (loss) per share from discontinued operations	$(6.95)	$(0.35)	$-	$0.75
Basic and diluted net earning (loss) per share	$(5.90)	$(0.86)	$(0.33)	$0.52

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	SIX MONTHS ENDED JUNE 30, 2015	SIX MONTHS ENDED JUNE 30, 2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss including noncontrolling interest	$(40,026,583)	$(6,900,205)
Adjustments to reconcile loss including noncontrolling interest to net cash used in operating activities:		
Investment loss	-	22,891
Depreciation and amortization	236,856	453,224
Provision for bad debts	175,487	(5,696,035)
Provision for inventory impairment	2,043,135	2,775,603
Provision for advances to suppliers	-	2,404,562
Changes in warranty reserves	2,777	43,848
Gain on debt waiver	(8,790,015)	-
Gain on issuance of stock	-	(70,000)
Gain on disposal of fixed asset	-	(6,926)
Loss on sale of equity interest	44,025,690	-
Stock based compensation for shares issued to officers and director	-	37,500
Changes in deferred tax	(25,109)	74,821
(Increase) decrease in assets and liabilities:		
Accounts receivable	879,076	3,495,711
Retentions receivable	72,282	244,023
Advances to suppliers	(32,384)	1,406,693
Other receivables, prepayments and deposits	(1,397,481)	(3,158,078)
Inventories	(420,484)	(1,148,034)
Taxes receivable	38,895	180,260
Accounts payable	(575,635)	(2,577,656)
Advances from customers	273,829	(2,838,655)
Accrued liabilities and other payables	1,189,260	3,125,224
Net cash used in operating activities	(2,330,404)	(8,131,229)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in restricted cash	53,355	1,592,388
Cash disposed in equity interest sale	(9,490,641)	-
Cash received from assets disposal	-	19,614
Acquisition of property and equipment	(7,160)	(708,625)
Government refund of land use right	-	10,364,498
Advance for equipment purchase	-	(1,248,997)
Notes receivable	-	2,061,939
Net cash provided by (used in) investing activities	(9,444,446)	12,080,817
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from bank loans	-	13,716,733

Repayment on bank loans	-	(12,968,975)
Change in credit line payable	310,000	850,000
Net cash provided by financing activities	310,000	1,597,758
EFFECT OF EXCHANGE RATE CHANGE ON CASH AND EQUIVALENTS	(43,656)	(153,128)
NET (DECREASE) / INCREASE IN CASH AND EQUIVALENTS	(11,508,506)	5,394,218
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	13,682,624	13,602,399
CASH AND EQUIVALENTS, END OF PERIOD	$2,174,118	$18,996,617
Supplemental cash flow data:		
Income tax paid	$-	$-
Interest paid	$-	$729,950

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2015 (Unaudited) AND YEARS ENDED DECEMBER 31, 2014 AND 2013

	Common stock							
	Shares	Amount	Paid in capital	Statutory reserves	Accumulated other comprehensive income	Accumulated deficit	Total	Noncon inte
Balance at January 1, 2013	5,733,399	$5,733	$103,607,559	$5,396,014	$11,273,497	$(11,771,349)	$108,511,454	$1,057
Shares issued for debt repayment	200,000	200	119,800	-	-	-	120,000	-
Shares issued for loan amendment fee	100,000	100	59,900	-	-	-	60,000	-
Shares issued for equity interest sale consent	100,000	100	29,900	-	-	-	30,000	-
Sale of 40% equity interest and deconsolidation	-	-	(16,423,553)	(9,537)	(4,924,845)	(5,187,502)	(26,545,437)	27,12
Net loss for year	-	-	-	-	-	(49,669,341)	(49,669,341)	(5,81
Transfer to statutory reserves	-	-	-	2,580	-	(2,580)	-	-
Foreign currency translation gain (loss)	-	-	-	-	2,642,617	-	2,642,617	(31,3
Balance at December 31, 2013	6,133,399	6,133	87,393,605	5,389,057	8,991,269	(66,630,772)	35,149,293	22,34
Shares issued to officers and directors	250,000	250	67,050	-	-	-	67,300	-
Shares issued for loan extension fee	400,000	400	39,800	-	-	-	40,200	-
Net loss for year	-	-	-	-	-	(9,567,988)	(9,567,988)	(3,31

Transfer to statutory reserves	-	-	-	-	-	-	-	-
Foreign currency translation loss	-	-	-	-	(441,701)	-	(441,701)	(15,8
Balance at December 31, 2014	6,783,399	6,783	87,500,456	5,389,057	8,549,568	(76,198,760)	25,247,104	19,00
Sale of 100% equity interest in certain subsidiaries	-	-	16,423,553	-	4,849,732	(3,288,257)	17,985,028	(18,7
Net loss for year	-	-	-	-	-	(40,010,159)	(40,010,159)	(16,4
Reclassification of statutory reserves of disposed entities to retained earnings as a result of 100% equity interest sale	-	-	-	(4,608,375)	-	4,608,375	-	-
Foreign currency translation gain (loss)	-	-	-	-	(570,224)	-	(570,224)	152
Balance at June 30, 2015	6,783,399	$6,783	$103,924,009	$780,682	$12,829,076	$(114,888,801)	$2,651,749	$202,0

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SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2015 (UNAUDITED) AND DECEMBER 31, 2014

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

SmartHeat Inc., formerly known as Pacific Goldrim Resources, Inc. (the "Company" or "SmartHeat"), was incorporated on August 4, 2006, in the State of Nevada. The Company, through its operating subsidiaries in China and Germany, designed, manufactured, sold and serviced plate heat exchangers ("PHEs"), PHE Units, which combine PHEs with various pumps, temperature sensors, valves and automated control systems, heat meters and heat pumps for use in commercial and residential buildings.

On August 23, 2013, the Company formed two new wholly-owned subsidiaries in the State of Nevada, Heat HP Inc., and HEAT PHE Inc. On the same date, the Company's United States ("US") parent entered into Assignment Agreements with Heat HP Inc. and Heat PHE Inc., respectively. Under the Assignment Agreements, the Company transferred 100% of its right, title and interest in certain subsidiaries to Heat HP Inc. and Heat PHE Inc. The reorganization was performed so the Company's subsidiaries would be organized along their respective operating segments with Heat HP holding those subsidiaries that operated in the heat pumps and related products segment and Heat PHE holding those subsidiaries that operated in the plate heating equipment, meters and related products segment.

After the assignment, Heat HP Inc. owned 100% of SmartHeat (China) Investment Co., Ltd. ("SmartHeat Investment"), SmartHeat (Shanghai) Trading Co., Ltd. ("SmartHeat Trading"), Beijing SmartHeat Jinhui Energy Technology Co., Ltd. ("Jinhui"), SmartHeat Deutschland GmbH ("SmartHeat Germany"), and 98.8% of SmartHeat (Shenyang) Heat Pump Technology Co., Ltd. ("SmartHeat Pump").

After the assignment, Heat PHE Inc. owned 100% of SmartHeat Taiyu (Shenyang) Energy Technology Co., Ltd. ("Taiyu"), SanDeKe Co., Ltd., ("SanDeKe"), SmartHeat Siping Beifang Energy Technology Co., Ltd. ("SmartHeat Siping"), SmartHeat (Shenyang) Energy Equipment Co., Ltd. ("SmartHeat Energy"), and 51% of Hohhot Ruicheng Technology Co., Ltd. ("Ruicheng").

On August 23, 2013, the Company entered into a Stock Pledge Agreement with Northtech Holdings Inc. ("Northtech"). The Company delivered share certificates to Northtech representing 55% of Heat HP Inc. and Heat PHE Inc. to perfect the security interest in each of the Company's directly and wholly-owned subsidiaries granted to Northtech as collateral security for all of the obligations of the Company to Northtech.

In December 2013, SmartHeat US parent incorporated SmartHeat Heat Exchange Equipment Co. ("Heat Exchange") in China with registered capital of $3.00 million for manufacturing and sale of PHE and PHE related products.

On December 30, 2013, the Company, closed the transaction contemplated by the Equity Interest Purchase Agreement ("EIPA") dated October 10, 2013, whereby the buyers purchased 40% of the Company's equity interests in the following PHE segment subsidiaries: Taiyu; SmartHeat Siping; SmartHeat Energy; Ruicheng; and XinRui (collectively, the "Target Companies"). The purchase price was RMB 5 million ($0.82 million). XinRui was 46% owned by SmartHeat US parent prior to the 40% equity interest sale.

On November 28, 2014, the Company entered into an Amended and Restated EIPA, which amended and restated the EIPA dated October 10, 2013 between the Company and the buyers. Under the terms of the Amended EIPA, the buyers agreed to purchase the remaining 60% of the Company's equity interests in the Target Companies effective as of December 31, 2014 (the "Closing Date"). The purchase price for the remaining 60% consists of: (i) RMB 8.5 million ($1.4 million) and (ii) the forgiveness of all net indebtedness of $11.75 million owed to the Target Companies by

SmartHeat and each of its other subsidiaries as of December 31, 2014 subject to termination provisions as set forth in EIPA.

The effectiveness of the transaction was subject to the following conditions: (i) approval of its shareholders and (ii) receipt by the Board of Directors (“BOD” or the “Board”) of the Company of an opinion that the purchase and sale transaction was fair to the shareholders of SmartHeat from a financial point of view. The parties executed a mutual release to be delivered at the closing which provided, in part, for the target companies to forgive all net indebtedness of $11.75 million from SmartHeat and all of its other subsidiaries. In the event that the conditions were not met prior to December 31, 2014, the consideration and all documents were to be deposited into escrow and released when the conditions were satisfied; provided that if the conditions were not satisfied on or before March 31, 2015, either party was able to terminate the Amended EIPA and the funds and documents were to be returned to the depositing party. The termination deadline of the Amended EIPA was extended to May 15, 2015.

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On May 11, 2015, the Company’s stockholders approved the sale of all of the remaining interests, constituting 100% of its ownership interests, (the “Stock Sale”) of certain subsidiaries of the Company as described above, all of the conditions precedents to the Stock Sale were satisfied. The parties executed a mutual release which became effective and provided, in part, that the Target Companies forgave all net indebtedness from SmartHeat and all of its other subsidiaries owed to the Target Companies. The consideration and all documents relating to the transaction were released from escrow upon the satisfaction of the foregoing conditions. The Stock Sale was effective on December 31, 2014.

The buyers consisted of 25 natural persons, all of whom are PRC citizens, including Wen Sha, Jun Wang and Xudong Wang, managers of the Company’s subsidiaries engaged in the PHE segment of its business, and Huajuan Ai and Yingkai Wang, the Company’s Corporate Secretary and Acting Chief Accountant, respectively. Huajuan Ai, Wen Sha, Jun Wang and Xudong Wang are also principals in Northtech.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”).

The consolidated interim financial information as of June 30, 2015 and for the six and three months ended June 30, 2015 and 2014, were prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with US GAAP are not included. The interim consolidated financial information should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K, for the fiscal year ended December 31, 2014, previously filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company’s consolidated financial position as of June 30, 2015, its consolidated results of operations for the six and three months ended June 30, 2015 and 2014, and its consolidated cash flows for the six months ended June 30, 2015 and 2014, as applicable, were made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

Principles of Consolidation

For the six and three months ended June 30, 2015, the accompanying consolidated financial statements include the accounts of SmartHeat’s US parent, its subsidiaries Heat HP and Heat PHE, and their subsidiaries SanDeKe, Jinhui, SmartHeat Investment, SmartHeat Trading, SmartHeat Germany, SmartHeat Pump, and Heat Exchange, which are collectively referred to as the “Company.” For the six and three months ended June 30, 2014, the accompanying consolidated financial statements include the accounts of SmartHeat’s US parent, its subsidiaries Heat HP and Heat PHE, and their subsidiaries Taiyu, SanDeKe, SmartHeat Siping, Jinhui, SmartHeat Investment, SmartHeat Energy, SmartHeat Trading, SmartHeat Germany, SmartHeat Pump, and Heat Exchange. All significant intercompany accounts and transactions were eliminated in consolidation.

Going Concern

The Company has incurred significant recurring losses from operations in the past several years, including a net loss from continuing operations of $4.79 million for the six months ended June 30, 2015. In addition, the Company recognized a loss of $35.24 million from the 100% equity interest sale on the entities sold, including foreign currency translation gain of $11.92 million. These conditions raise a substantial doubt about the Company's ability to continue as a going concern. However, since demand in China for heat pump products is increasing, the Company will put more resources and efforts to grow its heat pump business after completing the operational restructuring due to disposing of its PHE business. The Company expects to be able to obtain necessary bank loans for expanding the HP business.

Equity Method Investee

After the 40% equity interest sale on December 30, 2013, the Company owned 30.6% of Ruicheng (See Note 9) and 27.6% of XinRui for the six and three months ended March 31, 2014, which are accounted for under the equity method of accounting (FASB ASC Subtopic 323-30). The investment was recorded at the original cost, and the investment increased with income and decreased for dividends and losses accrued by the Company. On December 31, 2014, the Company sold the remaining 60% equity interest on Ruicheng and XinRui.

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Use of Estimates

In preparing the financial statements in conformity with US GAAP, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates, required by management, include the recoverability of long-lived assets, allowance for doubtful accounts and the reserve for obsolete and slow-moving inventories. Actual results could differ from those estimates.

Cash and Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of June 30, 2015 and December 31, 2014, the Company maintained restricted cash deposits in several bank accounts for the purposes described below.

	2015		2014	
	(In millions)			
Support of performance guarantee	$	0.01	$	0.41
Support of bank acceptance		-		0.70
Support of letter of credit		-		0.21
Financial product *		-		8.59
Total restricted cash - current	$	0.01	$	9.91
Performance guarantee - noncurrent	$	-	$	0.12

* Financial product mainly consisted of one certificate of deposit from a commercial bank in the PRC for RMB 40 million ($6.54 million), which was entered into on November 27, 2014 with maturity on January 7, 2015. The financial product had an expected annual interest rate of 4.5%.

The following table presents in US dollars ("USD") the amount of cash and equivalents held by the Company as of June 30, 2015 and December 31, 2014, based on the jurisdiction of deposit. The Company's US parent holds cash and equivalents in US bank accounts denominated in USD.

	United States		China		Germany		Total	
June 30, 2015	$	63,738	$	1,799,739	$	310,641	$	2,174,118
December 31, 2014	$	68,103	$	13,118,523	$	495,998	$	13,682,624

Accounts and Retentions Receivable, net

The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Based on historical collection activity, the Company had allowances of $1.57 million and $39.26 million at June 30, 2015 and December 31, 2014, respectively.

At June 30, 2015 and December 31, 2014, the Company had retentions receivable from customers for product quality assurance of $0.18 million and $3.64 million, respectively. The retention rate varies from 5% to 20% of the sales price with variable terms from three to 24 months depending on the shipping date, and for PHE Units, the customer acceptance date of the products and the number of heating seasons that the warranty period covers. The Company had allowances of $0.15 million and $2.33 million at June 30, 2015 and December 31, 2014, respectively.

Accounts receivable is net of unearned interest of $26,558 at December 31, 2014. Unearned interest is imputed interest on accounts receivable of disposed entities with due dates over one year from the invoice date discounted at the Company's borrowing rate of 6.15% at December 31, 2012. The Company did not record additional unearned interest after December 31, 2012 due from long-term accounts receivable.

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The Company records 50% and 100% of accounts receivable aged over 180 and 360 days, respectively, from the payment due date as bad debt allowance. Management of the Company's subsidiaries further analyzes each individual customer for which it was taken a bad debt allowance to further assess the likelihood of collectability. Customers which are either state-owned or have a history of support from the state, or larger companies with long operating histories, that management of the Company's subsidiaries believe the chance of non-payment will be remote, are excluded for the purpose of calculating bad debt allowance.

Advances to Suppliers, net

The Company makes advances to certain vendors to purchase raw material and equipment for production. The advances are interest-free and unsecured. As of June 30, 2015 and December 31, 2014, the Company had allowances for advances to suppliers of $2.42 million and $5.17 million, respectively.

Inventories, net

Inventories are valued at the lower of cost or market, with cost determined on a moving weighted-average basis. The difference is recorded as a cost of goods sold, if the current market value is lower than their historical cost. In addition, the Company makes an inventory impairment provision analysis at each period end for inventory held over 360 days. Cost of work in progress and finished goods comprises direct material, direct labor and an allocated portion of production overheads.

Certain raw materials, such as stainless steel products, plates, shims, gaskets, and pump valves, require longer than normal procurement periods, or "lead times," with some procurement periods running longer than six months. To guarantee availability of raw materials for production and sales, the Company's subsidiaries, based on historical sales patterns, estimate and purchase material for the upcoming periods.

As part of inventory impairment analysis, the Company performs an evaluation of raw materials stored over one year and not anticipated to be consumed, and an evaluation of potential impairment to the quality of these raw materials. If management anticipates that obsolete raw materials in inventory can be utilized and will be consumed within the next six months through new customer orders or substitute orders, no impairment is recorded. The Company collects information about delayed and canceled contracts and meets with affected customers to discuss their financing situation and their projections of future orders. Finished goods manufactured for delayed and canceled contracts that the Company does not expect to be reinstated and contracts for which the Company has been unable to find substitute customers become impaired.

Property and Equipment, net

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 with a 10% salvage value and estimated lives as follows:

Buildings	20 years
Vehicles	5 years
Office equipment	5 years
Production equipment	5-10 years

Land Use Rights, net

A right to use land is stated at cost less accumulated amortization. Amortization is provided using the straight-line method over 50 years.

Impairment of Long-Lived Assets

Long-lived assets, which include tangible assets, such as property and equipment, goodwill and other intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable.

Recoverability of long-lived assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized based on the excess of the carrying amount over the fair value (“FV”) of the assets. FV generally is determined using the asset’s expected future discounted cash flows or market value, if readily determinable.

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As stated in Note 1, on December 30, 2013, the Company closed the transaction contemplated by the EIPA dated October 10, 2013, whereby the buyers purchased 40% of the Company's equity interests in Taiyu, SmartHeat Siping, SmartHeat Energy, Ruicheng and XinRui for RMB 5 million ($0.82 million) and had the option to purchase the remaining 60% for an additional RMB 8.5 million ($1.39 million), which they did on December 31, 2014.

According to FASB ASC Subtopic 360-10-35, a long-lived asset (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate its carrying amount may not be recoverable. As of December 31, 2013, the Company believed the following events or changes in circumstances indicated the carrying amount of its long-lived assets (asset group) were not recoverable: 1) an expectation that, more likely than not, a long-lived assets (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life, and 2) a significant decrease in the market price of a long-lived asset (asset group). Since the Company had the option to sell 100% ownership in Target Companies for RMB13.5 million ($2.21 million), a significant decrease in the market price before the end of its previously estimated useful life for their long-lived assets, the Company therefore performed asset recoverability testing by comparing the assets' estimated future undiscounted cash flows with their carrying value, and concluded the long-lived assets were not recoverable as a result of future cash flows being less than the carrying amount. The Company further calculated the impairment losses of Target Companies by determining the FV for the long-lived asset group and recorded a write-down (loss) for the difference between their carrying value and their FV. FV is an asset's purchase or sale price in a current transaction between willing parties. The best evidence of FV is prices quoted in active markets, although the Company had the option to sell 100% ownership in Target Companies for RMB13.5 million ($2.21 million), the market prices were not available for many long-lived assets such as equipment, the Company therefore used discounted cash flow method for estimating the FV of long-lived assets which are acceptable under FASB ASC Subtopic 360-10.

Based on its evaluation, the Company believed, as of December 31, 2013, the long-lived assets of Target Companies including construction in progress, property and equipment, and intangible assets were impaired for $13.73 million. In addition, the Company retained remaining 30.6% and 27.6% interest in Ruicheng and XinRui (after the 40% sale), respectively, at December 31, 2013, that was accounted for under the equity method of accounting, the Company recorded the long-term investment in Ruicheng and XinRui at FV as provided in FASB ASC Subtopic 323-10-30-2. The FV of the long-term investment was the prorated selling price for the remaining 60% equity interest that were allocated to Ruicheng and XinRui for $26,720; accordingly, the Company recorded $0.91 million impairment loss of long-term investment in Ruicheng and XinRui for the excess of the carrying amount over the FV as of December 31, 2013.

Warranties

The Company offers all customers standard warranties on its products for one or two heating seasons depending on the terms negotiated. The Company accrues for warranty costs based on estimates of the costs that may be incurred under its warranty obligations. The warranty expense and related accrual is included in the Company's selling expenses and other payables respectively, and is recorded when revenue is recognized. Factors that affect the Company's warranty liability include the number of units sold, its estimates of anticipated rates of warranty claims, costs per claim and estimated support labor costs and the associated overhead. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Activity in the Company's warranty reserve from January 1, 2014, to June 30, 2015, is as follows:

	2015	2014
Beginning balance	$ 472,558	$ 472,558
Provisions	-	338,589
Actual costs incurred	(37,964)	(338,589)

Reversal of warranty reserve due to disposal of subsidiaries	(434,594)	-
Ending balance in current liabilities (Note 12)	$ -	$ 472,558

Research and Development Costs

Research and development ("R&D") costs are expensed as incurred and included in general and administrative ("G&A") expenses. These costs primarily consist of cost of materials used, salaries paid for the Company's development department and fees paid to third parties. R&D costs for the six months ended June 30, 2015 and 2014, were $0 and $403,917, respectively. R&D costs for the three months ended June 30, 2015 and 2014 were $0 and $246,546, respectively.

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Revenue Recognition

The Company's revenue recognition policies comply with FASB ASC Topic 605, "Revenue Recognition." Sales revenue is recognized when PHEs, heat meters and heat pumps are delivered, and for PHE Units when customer acceptance occurs, the price is fixed or determinable, no other significant obligations of the Company exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition met are recorded as unearned revenue under "Advance from customers." For the six and three months ended June 30, 2015, the Company only sold PHEs and heat pumps.

The Company's sales generally provide for 30% of the purchase price on placement of an order, 30% on delivery, 30% upon installation and acceptance of the equipment after customer testing and 10% no later than the termination of the standard warranty period, which ranges from three to 24 months from the acceptance date.

Sales revenue is the invoiced value of goods, net of value-added tax ("VAT"). All of the Company's products sold in the PRC are subject to a VAT of 17% of gross sales price. This VAT may be offset by the VAT paid by the Company on raw materials and other materials purchased in China and included in the cost of producing the Company's finished product. The Company recorded VAT payable and VAT receivable net of payments in the financial statements. The Company files VAT tax returns online with PRC tax authorities and offsets the payables against the receivables. SmartHeat Germany, the Company's German subsidiary, is subject to 19% VAT.

Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not affected by the income tax holiday.

Sales returns and allowances were $0 for the six and three months ended June 30, 2015 and 2014. The Company does not provide a right of return, price protection or any other concessions to its customers.

The Company provides a warranty to all customers, which is not considered an additional service; rather, an integral part of the product's sale. The Company believes the existence of its product warranty in a sales contract does not constitute a deliverable in the arrangement and thus there is no need to apply the FASB ASC Subtopic 605-25 separation and allocation model for a multiple deliverable arrangement. FASB ASC Topic 450, "Contingencies," specifically addresses the accounting for standard warranties. The Company believes that accounting for its standard warranty pursuant to FASB ASC Topic 450 does not impact revenue recognition because the cost of honoring the warranty can be reliably estimated.

The Company charges for after-sales services provided after the expiration of the warranty period, with after-sales services mainly consisting of cleaning PHEs and repairing and exchanging parts. The Company recognizes such revenue when the service is provided. For the six months ended June 30, 2015 and 2014, revenue from after-sales services after the expiration of the warranty was $18,990 and $93,784, respectively. For the three months ended June 30, 2015 and 2014, revenue from after-sales services after the expiration of the warranty was $14,833 and $47,540, respectively. Such revenue was recorded in other income.

Cost of Sales

Cost of sales ("COS") consists primarily of material costs and direct labor and manufacturing overhead directly attributable to the products. The Company also records reserve for inventories to COS.

Advances from Customers

The Company records payments received from customers in advance of their orders to advance account. These orders normally are delivered within a reasonable period of time based upon contract terms and customer demand.

Statement of Cash Flows

In accordance with FASB ASC Topic 230, "Statement of Cash Flows," cash flows from the Company's operations are calculated based upon the local currencies. As a result, amounts shown on the statement of cash flows may not necessarily agree with changes in the corresponding asset and liability on the balance sheet.

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Basic and Diluted Earnings (Loss) per Share (EPS)

Basic 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 similarly, 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 EPS are 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 have been 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.

Basic and diluted shares outstanding are the same for each of the six and three months ended June 30, 2015 and 2014, because the convertible securities outstanding, consisting of unexercised options issued to the Company's directors and an officer, were anti-dilutive and, accordingly, were excluded from the computation of diluted loss per share. At June 30, 2015 and December 31, 2014, no options and options to purchase 2,500 shares of common stock were outstanding and exercisable, respectively.

Foreign Currency Translation and Comprehensive Income (Loss)

The accounts of the US parent company are maintained in USD. The functional currency of the Company's China subsidiaries is the Chinese Yuan Renminbi ("RMB") and the functional currency of SmartHeat Germany, the Company's subsidiary in Germany, is the Euro ("EUR"). The accounts of the China subsidiaries and German subsidiary were translated into USD in accordance with FASB ASC Topic 830, "Foreign Currency Matters." According to FASB ASC Topic 830, all assets and liabilities were translated at the exchange rate on the balance sheet date, stockholders' equity was translated at the historical rates and statement of operations items were translated at the average exchange rate for the period. The resulting translation adjustments are reported under other comprehensive income in accordance with FASB ASC Topic 220, "Comprehensive Income."

The Company sold 100% equity interest on certain subsidiaries with 40% sold on December 30, 2013 and the remaining 60% sold on December 31, 2014. According to ASC 830-30-40-1, upon the sale of a subsidiary, accumulated foreign currency translation adjustment relating to the disposed entities as of December 31, 2014 amounting to $7.1 million was reported separately in the Consolidated Statements of Operations and Comprehensive Income (Loss) as cumulative foreign currency translation gain on disposed entities, and was part of the loss on sale.

RMB to USD and EUR to USD exchange rates in effect as of June 30, 2015 and December 31, 2014, and the average exchange rates for the six months ended June 30, 2015 and 2014 are as following. The exchange rates used in translation from RMB to USD were published by State Administration of Foreign Exchange ("SAFE") of the PRC. The exchange rates used in translation from EUR to USD were published by OANDA Rates.

	Average Exchange Rate For the Six Months Ended		Balance Sheet Date Exchange Rate	
	6/30/15	6/30/14	6/30/15	12/31/14
RMB - USD	6.1288	6.1180	6.1136	6.1190
EUR - USD	0.8952	0.7295	0.9014	0.8266

Segment Reporting

FASB ASC Topic 280, “Segment Reporting,” requires use of the “management approach” model for segment reporting. The management approach model is based on the way a company’s management organizes segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure, or any other manner in which management disaggregates a company.

The Company had two operating segments at December 31, 2014: 1) plate heating equipment, meters and related products; and 2) heat pumps and related products. These operating segments were determined based on the nature of the products offered. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. The Company's chief executive officer and acting chief accountant were identified as the chief operating decision makers. The Company’s chief operating decision makers direct the allocation of resources to operating segments based on profitability, cash flows, and other measurement factors of each respective segment.

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As a result of the 100% Stock Sale of certain subsidiaries effective December 31, 2014, the Company is now concentrating on heat pump business, whereas the PHE business is very limited and will be gradually ceased. For the six months ended June 30, 2015, sales of PHEs was $42,423 and sales of heap pumps was $1,418,344. For the three months ended June 30, 2015, sales of PHEs was $0 and sales of heap pumps was $683,525. Both businesses report to the same executives. Accordingly, there was no segment reporting for the six and three months ended June 30, 2015 due to immaterially of PHE segment.

New Accounting Pronouncements

In August 2014, the FASB issued Presentation of Financial Statements — Going Concern. This standard requires management to evaluate for each annual and interim reporting period whether it is probable that the reporting entity will not be able to meet its obligations as they become due within one year after the date that the financial statements are issued. If the entity is in such a position, the standard provides for certain disclosures depending on whether or not the entity will be able to successfully mitigate its going concern status. This guidance is effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. Early application is permitted. The Company does not anticipate that this adoption will have a significant impact on its consolidated financial position, results of operations, or cash flows.

The Financial Accounting Standards Board (“FASB”) has issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers. This ASU supersedes the revenue recognition requirements in Accounting Standards Codification 605 - Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective on January 1, 2017 and should be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized at the date of initial application. In April 2015, the FASB proposed a one-year delay in the effective date and companies will be allowed to early adopt as of the original effective date. The Company is in the process of evaluating the impact of adoption of this guidance on the consolidated financial statements.

The FASB has issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This ASU requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position and results of operations.

In February 2015, the FASB issued ASU 2015-02, “Consolidation (Topic 810) - Amendments to the Consolidation Analysis”, which provides guidance for reporting entities that are required to evaluate whether they should consolidate certain legal entities. In accordance with ASU 2015-02, all legal entities are subject to reevaluation under the revised consolidation model. ASU 2015-02 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. The Company does not anticipate that this adoption will have a significant impact on its consolidated financial position, results of operations, or cash flows.

As of June 30, 2015, there is no recently issued accounting standards not yet adopted that would have a material effect on the Company’s consolidated financial statements.

Reclassification

Certain prior year amounts were reclassified to conform to the manner of presentation in the current period. These reclassifications had no effect on the Company’s net loss or stockholders’ equity.

3. INVENTORIES, NET

Inventories at June 30, 2015 and December 31, 2014, were as follows:

	2015	2014
Raw materials	$ 6,969,801	$ 47,748,997
Work in process	716,770	8,473,197
Finished goods	2,063,071	11,655,631
Total	9,749,642	67,877,825
Inventory allowance	(4,324,248)	(18,528,630)
Inventories, net	$ 5,425,394	$ 49,349,195

4. NOTES RECEIVABLE – BANK ACCEPTANCES

The Company sold goods to its customers and received commercial notes (bank acceptances) from them in lieu of payments. The Company discounted the commercial notes with the banks or endorsed the commercial notes to vendors for payment of their own obligations or to get cash from third parties. Most of the commercial notes have a maturity of less than nine months. As of June 30, 2015 and December 31, 2014, the Company was contingently liable for the notes endorsed to vendors of $0 and $0.92 million, respectively.

5. OTHER RECEIVABLES (NET), PREPAYMENTS AND DEPOSITS

Other receivables, prepayments and deposits consisted of the following at June 30, 2015 and December 31, 2014, respectively:

	2015	2014
Advances to third party companies	$ 1,406,168	$ 14,212,310
Deposit for public bids of sales contracts	40,075	168,235
Prepayment for freight, related insurance, advertisement and consulting expenses	26,982	287,998
Other deposits	4,137	60,185
Advances to employees	374,010	1,334,715
Other	86,607	676,157
Total	1,937,979	16,739,600
Less: bad debt allowance	(187,909)	(11,671,189)
Other receivables (net), prepayments and deposits	$ 1,750,070	$ 5,068,411

As of June 30, 2015, advances to third party companies were short-term unsecured advances to unrelated parties with payments due within a year. As of December 31, 2014, advances to third party companies included an advance to Siping Beifang of RMB 22.13 million ($3.60 million) that was non-interest bearing and with due date extended to the end of 2015. The Company had bad debt allowance of $3.60 million for advance to Siping Beifang as of December 31, 2014.

Deposits for public bidding represented the deposits for bidding on expected contracts, which will be returned to the Company after the bidding process is completed, usually within three to four months from the payment date. Prepayment for freight and related insurance expenses represented prepaid shipping and freight insurance expenses for customers and is generally repaid upon customer receipt of products.

Other deposits mainly consisted of deposits for rents, payroll expense and utilities. Advances to employees represented short-term loans to employees and advances for business trips and related expenses.

Other receivables, prepayments and deposits are reimbursed or settled within 12 months.

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6. PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following at June 30, 2015 and December 31, 2014:

	2015	2014
Buildings	$ -	$ 4,967,230
Production equipment	1,686,421	9,134,092
Office equipment	210,124	1,139,249
Vehicles	244,548	932,657
Total	2,141,093	16,173,228
Less: accumulated depreciation	(1,082,825)	(5,661,537)
Less: impairment	-	(8,516,171)
Property and equipment, net	$ 1,058,268	$ 1,995,520

Depreciation for the six months ended June 30, 2015 and 2014 was $117,482 and $178,592, respectively. Depreciation for the three months ended June 30, 2015 and 2014 was $57,821 and $84,179, respectively.

7. INTANGIBLE ASSETS, NET

Intangible assets consisted mainly of trademarks, computer software and know-how technology. As of December 31, 2014, intangible assets also consisted of land use right of $4.13 million. All land in the PRC is government-owned and cannot be sold to any individual or company. However, the government grants the user a “land use right” to use the land. The Company acquired land use rights during 2005 for RMB 3.55 million ($0.44 million). In June 2009, the Company acquired land use rights for $3.1 million from Siping Beifang. In November 2010, the Company’s subsidiary, SmartHeat Energy, acquired land use rights for $10.10 million. The Company had the right to use the land for 50 years and amortized such rights on a straight-line basis over that period. SmartHeat Energy later canceled the purchase of the land use right due to the adjustments of the overall development plan of the area by the local authority and received a full refund in June 2014.

Intangible assets consisted of the following at June 30, 2015 and December 31, 2014, respectively:

	Estimated Useful Life (In years)	2015	2014
Land use rights	50	$ -	$ 4,134,587
Know-how technology	5 – 10	610,660	610,121
Software	5	153,325	460,899
Trademarks	7	297,735	297,471
Total		1,061,720	5,503,078
Less: accumulated amortization		(554,055)	(1,097,055)
Less: impairment of land use rights		-	(3,829,024)
Intangible assets, net		$ 507,665	$ 576,999

Amortization of intangible assets for the six months ended June 30, 2015 and 2014 was $69,553 and $199,532, respectively. Amortization of intangible assets for the three months ended June 30, 2015 and 2014 was $34,819 and $71,837, respectively. Annual amortization for the next five years from June 30, 2015 is expected to be $134,589,

$133,488, $101,680, $69,751 and $66,897, and $1,259 thereafter.

8. CONSTRUCTION IN PROGRESS

As of June 30, 2015, the Company had construction in progress of $0 as a result of 100% Stock Sale of certain subsidiaries. As of December 31, 2014, SmartHeat Siping had construction in progress of $84,533 for expanding and upgrading its production line and production equipment. Total cost for the construction is $0.98 million, and was expected to complete in September 2015.

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9. LONG TERM INVESTMENT

Prior to December 30, 2013, the Company invested $722,700 to establish XinRui. The Company owned 46% of XinRui and accounted for this investment under the equity method. On December 30, 2013, the Company sold 40% equity interest of XinRui and owns 27.6% of XinRui after the sale (See Note 2). The carrying amount of investment in XinRui after the sale was $612,808. On December 31, 2014, the Company sold the remaining 60% equity interest on XinRui.

Prior to December 30, 2013, the Company invested $771,600 for 51% of the equity in Ruicheng. The Company sold 40% equity interest of Ruicheng on December 30, 2013, and owns 30.6% of Ruicheng after the sale (See Note 2). The carrying amount of investment in Ruicheng after the sale was $321,997. On December 31, 2014, the Company sold the remaining 60% equity interest on Ruicheng.

The long-term investment was accounted for under the equity method of accounting, the Company recorded the long-term investment in Ruicheng and XinRui at FV as provided in FASB ASC Subtopic 323-10-30-2. The FV of the long term investment was the prorated selling price for the remaining 60% equity interest that were allocated to Ruicheng and XinRui for $26,721 at December 31, 2013, accordingly, the Company recorded $0.91 million impairment loss of long term investment in Ruicheng and XinRui for the excess of the carrying amount over the FV for the year ended December 31, 2013. The FV of the long-term investment was $29,540 at December 31, 2014.

The Company did not have any long-term investment as of June 30, 2015 as a result of 100% Stock Sale of certain subsidiaries on December 31, 2014.

10. TAXES RECEIVABLE

Taxes receivable consisted of the following at June 30, 2015 and December 31, 2014:

	2015	2014
Income	$ -	$ 180,111
Value-added	6,643	122,816
Other	2,473	22,325
Taxes receivable	$ 9,116	$ 325,252

11. TAXES PAYABLE

Taxes payable consisted of the following at June 30, 2015 and December 31, 2014:

	2015	2014
Income	$ 33,999	$ -
Value-added	3,820	160,033
Other	14,744	36,213
Taxes payable	$ 52,563	$ 196,246

12. ACCRUED LIABILITIES AND OTHER PAYABLES

Accrued liabilities and other payables consisted of the following at June 30, 2015 and December 31, 2014:

	2015	2014
Advances from third parties	$ 647,555	$ 3,273,985

Payable to Siping Beifang		-		2,368,285
Payable for equipment purchase		-		326,688
Payable to employees		-		226,308
Customer deposit		-		2,977,447
Refund of land use right purchased		-		4,816,685
Other		1,114,903		2,805,560
Warranty reserve (See Note 2)		-		472,558
Accrued expenses		1,668,778		2,051,945
Accrued liabilities and other payables	$	3,431,236	$	19,319,461

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Advances from third parties were short term, non-interest-bearing and due on demand. Payable to Siping Beifang (unrelated third party company) represented loans to it without interest and payable upon demand. Customer deposit represented an advance payment from a customer for the Company to execute a sales order; however, the customer wanted to cancel the order after the Company commenced manufacturing and the Company refused to return the deposit claiming breach of contract by the customer. The dispute was filed with the court and is currently docketed for trial.

Refund of land use right previously purchased represented the refund received for the land use right SmartHeat Energy purchased in November 2010. SmartHeat Energy later cancelled the purchase due to the adjustments of the overall development plan of the area by the local authority. The local government agreed to the cancellation and refunded SmartHeat Energy $4.63 million as of December 31, 2013, and was committed to refund SmartHeat Energy the remaining purchase price. On May 21, 2014, SmartHeat Energy and Shenyang City Development and Land Resource Bureau Economy and Technology Development Office entered into an official agreement, whereby full purchase price of the land use right was to be returned to SmartHeat Energy in installments within five days from the effective date of the official agreement. SmartHeat Energy was to make the ownership change of the land use right upon receiving the refund from the local authority. As of December 31, 2014, SmartHeat Energy received a total of $14.89 million (RMB 91.62 million), of which, $4.82 million received was in excess of the amount paid to acquire the land use right. The local government has not yet made qualitative determination about the excess amount and until such time SmartHeat Energy receives further information, the excess amount will be recorded as other payable. The land use right title transfer is expected to be completed by the end of 2015. Currently the land is used by a third party.

Other represented payables for the Company's certain construction and installation projects, and miscellaneous expenses including postage, business insurance, employee benefits, project bidding fee, medical insurance, etc.

As of June 30, 2015, accrued expenses mainly consisted of accrued property and land rental fee of $1.23 million, and accrued payroll of $104,690. As of December 31, 2014, accrued expenses mainly consisted of accrued property and land rental fee of $1.23 million, accrued payroll of $0.36 million, accrued welfare, interest and utility. The accrued rent of $1.23 million represented the office and factory lease of HeatPump from Shenyang Economic and Technological Development Zone State-owned Assets Management Co., Ltd., who is the minority shareholder of HeatPump, there was no contract for the lease and the lease was on a month-to-month basis.

13. NOTES PAYABLE – BANK ACCEPTANCES

Notes payable represented the conversion of accounts payable into notes payable, which were issued by a bank. The Company deposited a portion of the acceptance amount into the bank as collateral. The terms of the notes range from three to six months and bear no interest. At December 31, 2014, the Company deposited $0.70 million with the bank as restricted cash for the bank issuing the notes (See note 2). The restricted cash is refundable when the notes are repaid.

14. LOANS PAYABLE

Short Term Bank Loans

The Company was obligated for the following short-term loans from various commercial banks as of December 31, 2014:

		2014	Subsidiary obligated
Due February 19, 2015 with interest of 6.00%	$	1,176,663	Taiyu
		3,268,508	Taiyu

Due August 11, 2015 with interest of 7.20%, guaranteed by Heat Pump and SanDeKe			
Due August 19, 2015 with interest of 7.20%, guaranteed by Heat Pump and SanDeKe		3,268,508	Taiyu
Due March 17, 2015 with interest of 7.20%, secured by Taiyu's accounts receivable		1,432,442	Taiyu
Due April 22, 2015 with interest of 7.20%, guaranteed by Siping, Heat Pump, SanDeKe, and two officers of the Chinese subsidiaries		5,883,314	Taiyu
Due April 22, 2015 with interest of 7.20%, guaranteed by Siping, Heat Pump, SanDeKe, and two officers of the Chinese subsidiaries		653,702	Taiyu
Due April 15, 2015 with interest of 7.20%		4,035,527	Taiyu
Due October 29, 2015 with interest of 6.46%, secured by Taiyu's land and building		2,124,530	Taiyu
Due November 17, 2015 with interest of 7.00%, guaranteed by Taiyu		1,634,254	SmartHeat Siping
Due September 19, 2015 with interest of 5.60%, guaranteed by Taiyu		1,634,254	SmartHeat Siping
TOTAL	$	25,111,702	

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The banks sometimes require loan guarantees provided by a third party to the Company, the third party loan guarantor was Liaoning Wugang Metal Trading Co., Ltd. (“Liaoning Wugang”), with a maximum guarantee of RMB 44 million ($7.05 million). The guarantee was for the loans entered through September 12, 2014 with the guarantee length equal to the loan term. The Company was not required to pay any guarantee fees. However, the Company has contracted to provide similar guarantees for up to RMB 20 million ($3.18 million) to Liaoning Guorui Commercial Trading Co., Ltd. (“Guorui”). The guarantee was for the loans entered from January 12, 2012 to January 11, 2013 with the guarantee length equal to the loan term, the Company did not require Guorui to pay any guarantee fees. The Company did not extend the guarantee term for Guorui after January 11, 2013. These arrangements are common to the banking industry in China, and there are no other relationships between the Company and Liaoning Wugang or Guorui, both of whom were referred to the Company by the lending bank. As of December 31, 2014, the Company did not have any loan guarantees from Liaoning Wugang.

Holding Company Credit Agreement – Credit Line Payable

On July 27, 2012, the Company entered into a secured, revolving credit facility under the terms of a Secured Credit Agreement (the “Credit Facility” or the “Credit Agreement”) with Northtech Holdings Inc., a British Virgin Islands business corporation (“Northtech”), owned by certain members of the Company’s former management, James Wang, Rhett Wang and Wen Sha, Jane Ai, the Company’s Corporate Secretary is also a part owner of Northtech. As amended on December 21, 2012, the Credit Facility provides for borrowings of up to $2.5 million.

An origination fee of 4% of the Committed Amount was accrued to Northtech upon the signing of the Credit Agreement. As amended, Borrowings bear interest of 10%, payable quarterly, and the Credit Facility matured on April 30, 2013, and extended to April 30, 2014 with an extension fee of 4% of the Committed Amount. Generally, borrowings may be prepaid at any time without premium or penalty, provided however that if the Company prepays any amount due under the Credit Facility from the proceeds of another instrument or agreement of indebtedness, the Company shall pay a 10% prepayment fee. All amounts due under the Credit Facility may, at the Company’s option, be paid in either cash or restricted shares of the Company’s common stock.

On June 25, 2013, the BOD approved a second amendment to the credit and security agreement and on August 23, 2013, the Company entered into a second amendment to the credit and security agreement with Northtech, which redefined the “base rate”, and adjusted the base rate to 10% annually, compounded quarterly, effective January 1, 2013. The Company delivered to Northtech 100,000 restricted shares of the Company’s common stock as an Amendment Fee, issued in September 2013.

On December 21, 2012, the Company’s BOD approved the issuance of 1,300,000 Restricted Shares of Common Stock to Northtech in cancellation of $1,301,300 of indebtedness under the Credit Facility.

The Company had $100,000 payable to a consulting firm that was paid by a third party on behalf of the Company during 2012, this payable to the third party was assumed by Northtech on August 23, 2013, in exchange for 200,000 shares of the Company’s common stock issued in September 2013, and payable for a credit line balance from Northtech. The stock price was $0.60 on August 23, 2013, the Company recognized $20,000 loss for the settlement of this payable by shares with Northtech.

On March 26, 2014, the Company gave notice to Northtech pursuant to the terms of the Credit and Security Agreement between the Company and Northtech, dated July 27, 2012, as amended, extending the maturity date on the Credit Agreement from April 30, 2014 to January 3, 2015. The Company elected to pay the extension fee of 4% of the credit line amount of $2.5 million by issuing 200,000 shares of its common stock to Northtech at $0.50 per share (equal to $100,000). The BOD approved such extension on March 27, 2014. The FV of 200,000 shares on March 27, 2014 was $30,000. The Company recorded $70,000 gain from issuance of 200,000 shares.

On July 14, 2014, the BOD approved and the Company entered the third amendment to the Credit Agreement with Northtech, the Amendment modified the definition of "Average Share Price" in the Credit Agreement to decrease the minimum and maximum values for the "Average Share Price," by 20% each from \$0.50 to \$0.40 and from \$3.50 to \$2.80, respectively. The Amendment also increased the maximum line, which may be borrowed under the Credit Agreement from \$2,500,000 to \$3,250,000 and extended the maturity date for amounts borrowed from April 30, 2014 to October 31, 2015. Pursuant to the terms of the Amendment, the Company extended the Initial Maturity Date by a payment to Northtech of an extension fee of 4% of the Maximum Line under the Credit Agreement. Northtech agreed to the extension of the maturity in consideration of an extension fee of 200,000 Restricted Shares of the Company's Common Stock at \$0.50 per share issued on July 22, 2014. The FV of 200,000 shares on July 22, 2014 was \$40,000. The Company recorded \$60,000 gain from issuance of the 200,000 shares.

As of June 30, 2015 and December 31, 2014, the outstanding credit line payable to Northtech was \$3,384,335 and \$2,749,335, respectively.

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15. DEFERRED TAX ASSET (LIABILITY)

As of June 30, 2015 and December 31, 2014, deferred tax asset (liability) consisted of the following:

	2015	2014
Deferred tax asset - current (bad debt allowance for accounts receivable)	$ 392,994	$ 6,361,682
Deferred tax asset - current (bad debt allowance for retention receivable)	37,086	364,697
Deferred tax asset - current (inventory allowance)	1,081,062	3,446,251
Deferred tax asset – current (bad debt allowance for other receivables)	46,977	2,822,959
Deferred tax asset – current (allowance for advance to supplier)	607,170	589,761
Deferred tax asset – current (reserve for warranty)	-	42,643
Deferred tax asset – noncurrent (NOL of US parent company)	19,313,454	2,931,171
Deferred tax asset – noncurrent (NOL of PRC subsidiaries)	3,719,606	3,781,687
Deferred tax asset – noncurrent (impairment loss on long – lived assets)	-	3,054,588
Less: valuation allowance	(25,198,349)	(23,395,439)
Deferred tax assets, net	$ -	$ -
Deferred tax liability - noncurrent (depreciation of fixed assets)	$ (40,911)	$ (66,024)

16. INCOME TAXES

The Company is subject to income taxes by entity on income arising in or derived from the tax jurisdiction in which each entity is domiciled. The Company's PRC subsidiaries file their income tax returns online with PRC tax authorities.

SmartHeat, the parent company, was incorporated in the US and has net operating losses ("NOL") for income tax purposes, which can be carried forward for up to 20 years from the year the loss is incurred. SmartHeat has NOL carry forwards for income taxes of approximately $59.33 million at June 30, 2015, which may be available to reduce future years' taxable income. Management believes the realization of benefits from these losses remains uncertain due to SmartHeat's limited operating history and continuing losses. Accordingly, a 100% deferred tax asset valuation allowance was provided.

Taiyu and SanDeKe are governed by the Income Tax Law of the PRC concerning privately-run enterprises, which are generally subject to tax at 25% on income reported in the statutory financial statements after appropriate tax adjustments. Under the Income Tax Law that became effective January 1, 2008, new high-tech enterprises given special support by the PRC government are subject to an income tax rate of 15%. Taiyu has been classified as a high-tech enterprise since 2009 and eligible for an income tax rate of 15% through 2014. Local PRC government reviews the high-tech status of such enterprises annually. The income tax rate for SanDeKe was 13% for 2012, because of its foreign-invested enterprise status, and its income tax rate increased to 24% in 2013 and 25% in 2014.

SmartHeat Siping, Jinhui, SmartHeat Investment, SmartHeat Energy, SmartHeat Pump, SmartHeat Trading and Heat Exchange are subject to the regular 25% PRC income tax rate. SmartHeat Germany is subject to a 15% corporate income tax in Germany.

The following table reconciles the US statutory rates to the Company's effective tax benefit rate for the six months ended June 30, 2015 and 2014:

	2015	2014
US statutory tax benefit rates	(34.0)%	(34.0)%
Tax rate difference	7.3%	7.5%

Effect of tax holiday	-%	-%
Other	0.7%	-%
Valuation allowance	26.2%	28.9%
Tax expense per financial statements	0.2%	2.4%

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The following table reconciles the US statutory rates to the Company's effective tax (benefit) rate for the three months ended June 30, 2015 and 2014:

	2015	2014
US statutory tax (benefit) rates	(34.0)%	(34.0)%
Tax rate difference	7.5%	8.2%
Effect of tax holiday	-%	-%
Other	-%	5.6%
Valuation allowance	25.8%	26.0%
Tax expense (benefit) per financial statements	(0.7)%	5.8%

The income tax (benefit) for the six months ended June 30, 2015 and 2014, consisted of the following:

		2015		2014
Income tax expense - current	$	33,940	$	672
Income tax expense (benefit) - deferred		(25,109)		74,821
Total income tax expense, net	$	8,831	$	75,493

The income tax benefit for the three months ended June 30, 2015 and 2014, consisted of the following:

		2015		2014
Income tax expense (benefit) - current	$	(1,987)	$	1,058
Income tax expense (benefit) - deferred		(12,540)		88,971
Total income tax expense (benefit), net	$	(14,527)	$	90,029

17. STATUTORY RESERVES AND RESTRICTED NET ASSETS

The Company's ability to pay dividends primarily depends on the Company receiving funds from its subsidiaries. Relevant PRC statutory laws and regulations permit payments of dividends by the Company's PRC subsidiaries only out of the subsidiary's retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. The results of operations reflected in the financial statements prepared in accordance with US GAAP differ from those reflected in the statutory financial statements of the Company's PRC subsidiaries.

In accordance with the PRC Regulations on Enterprises with Foreign Investment and their articles of association, a foreign-invested enterprise ("FIE") established in the PRC is required to provide certain statutory reserves, which are appropriated from net profit as reported in the FIE's PRC statutory accounts. An FIE is required to allocate at least 10% of its annual after-tax profit to the surplus reserve until such reserve has reached 50% of its respective registered capital based on the FIE's PRC statutory accounts. Appropriations to other funds are at the discretion of the BOD for all FIEs. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends. Additionally, shareholders of an FIE are required to contribute capital to satisfy the registered capital requirement of the FIE. Until such contribution of capital is satisfied, the FIE is not allowed to repatriate profits to its shareholders, unless otherwise approved by the State Administration of Foreign Exchange. Taiyu, SanDeKe, SmartHeat Siping, Jinhui, SmartHeat Investment and Ruicheng were established as FIEs and therefore are subject to the above-mandated restrictions on distributable profits. As of December 31, 2014, the Company met all registered capital requirements for its FIEs except for SmartHeat Investment, for which the Company is committed to contribute an additional $40 million in registered capital by the end of 2015 (See note 19).

Additionally, in accordance with the Company Laws of the PRC, a domestic enterprise is required to provide surplus reserve at least 10% of its annual after-tax profit until such reserve has reached 50% of its respective registered capital based on the enterprise's PRC statutory accounts. A domestic enterprise is also required to provide discretionary surplus reserve, at the discretion of the BOD, from the profits determined in accordance with the enterprise's PRC statutory accounts. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends. SmartHeat Energy, SmartHeat Trading and SmartHeat Pump were established as domestic enterprises and therefore are subject to the above-mentioned restrictions on distributable profits.

As a result of these PRC laws and regulations that require annual appropriations of 10% of after-tax income to be set aside prior to payment of dividends as general reserve fund, the Company's PRC subsidiaries are restricted in their ability to transfer a portion of their net assets to the Company as a dividend.

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18. STOCKHOLDERS' EQUITY

Stock Options to Independent Directors and Officer

On February 1, 2010, the Company issued stock options to an officer. The terms of the options were 5,000 shares at an exercise price per share of $118.50, with a life of five years and vesting over two years as follows: 2,500 shares vested on June 30, 2011, and 2,500 shares vested on June 29, 2012. The options were valued using a volatility of 74%, risk free interest rate of 2.76%, and dividend yield of 0%. The grant-date FV of the options was $367,107. On May 25, 2012, the officer resigned from his position as VP of Strategy and Development of the Company, and was not entitled to the remaining unvested options. The remaining obligations of the Company to the officer were released pursuant to a severance agreement and mutual release. The 2,500 shares vested on June 30, 2011 became expired without exercise on January 31, 2015.

Based on the FV method under FASB ASC 718, "Compensation-Stock Compensation," and FASB ASC 505, "Equity," the FV of each stock option granted is estimated on the date of the grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model has assumptions for risk-free interest rates, dividends, stock volatility and expected life of an option grant. The risk-free interest rate is based upon market yields for US Treasury debt securities at a maturity near the term remaining on the option. Dividend rates are based on the Company's dividend history. The stock volatility factor is based on the historical volatility of the Company's stock price. The expected life of an option grant is based on management's estimate. The FV of each option grant to independent directors is calculated by the Black-Scholes method and is recognized as compensation expense over the vesting period of each stock option award.

There were no options exercised during the six and three months ended June 30, 2015 and 2014. The Company recorded no compensation expense for stock options during the six and three months ended June 30, 2015 and 2014.

Common Stock Issued

On March 27, 2014, The Compensation Committee of the BOD granted certain individuals the Company's common stock in recognition of their valuable services to the Company and its subsidiaries in 2013. The individual and number of shares granted is as follows: 100,000 shares to Oliver Bialowons, 50,000 shares to Huajun Ai, 50,000 shares to Xudong Wang and 50,000 shares to Kenneth Scipta. The stock price was $0.15 on grant date, and the FV of the shares granted at the grant date was $37,500 and were issued on April 3, 2014.

On March 27, 2014, the BOD approved the Company's request to Northtech for extending the maturity date on the Credit Agreement from April 30, 2014 to January 3, 2015, and to pay the extension fee of 4% of the credit line amount of $2.5 million, or $100,000, by issuing 200,000 shares of its common stock to Northtech. The FV of 200,000 shares on the grant date was $30,000 and the Company recognized $70,000 gain from such stock issuance. The shared were issued on April 3, 2014.

On July 14, 2014, the Company entered the third amendment to the Credit Agreement with Northtech, Pursuant to the terms of the Amendment, the Company extended the Initial Maturity Date by a payment to Northtech of an extension fee of 4% of the Maximum Line under the Credit Agreement, or $100,000. Northtech agreed to the extension of the maturity in exchange for 200,000 restricted shares issued on July 22, 2014. The FV of 200,000 shares on July 22, 2014 was $40,000 and the Company recognized $60,000 gain from such stock issuance.

Change of Paid in Capital

Upon the sale of 40% equity interest on December 30, 2013, the Company reclassified $16,423,553 paid in capital to noncontrolling interest as a result of deconsolidation with no gain or loss on disposal recognized in accordance with US GAAP as the Company still retained a controlling interest. Upon the approval of the sale of the remaining 60% equity interest on May 11, 2015, effective December 31, 2014, the Company reclassified $16,423,553 from noncontrolling interest's equity to loss on sale of 100% equity interest on certain subsidiaries.

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19. COMMITMENTS

Lease Agreements

The Company leased offices for its sales representatives in several different cities under various one-year, non-cancellable and renewable operating lease agreements. Rental expense for the six months ended June 30, 2015 and 2014 was $139,243 and $199,574, respectively. Rental expense for the three months ended June 30, 2015 and 2014 was $68,841 and $115,396, respectively.

Capital Contribution

The Company formed SmartHeat Investment on April 7, 2010, as an investment holding company with registered capital of $70 million to enable its establishment and investment in new businesses in China. Under PRC company law, registered capital must be used in the operations of the domestic company within its approved business scope. SmartHeat Investment was established as a separate subsidiary of the Company to allow allocation of capital to new businesses in China separate from its existing subsidiaries and operations. As a PRC investment holding company, the $70 million in approved registered capital of SmartHeat Investment is deemed a planned investment amount for the entity, not a traditional registered capital requirement under PRC corporate law. The Company contributed $30 million in capital to SmartHeat Investment on April 15, 2010, from proceeds of its public offering that closed on September 22, 2009. On April 12, 2010, SmartHeat Investment formed SmartHeat Energy, a wholly owned subsidiary in Shenyang with registered capital of $30 million, subsequently satisfied out of the registered capital of SmartHeat Investment, for the research, development, manufacturing and sale of energy products. As of June 30, 2015, the Company is committed to contributing the remaining $40 million in registered capital to SmartHeat Investment by the end of 2015. The Company may satisfy this contribution through cash flow provided by operations, sales of assets, such as physical assets, financial assets, or interests in its subsidiaries, and funds raised through offerings of its securities, if and when the Company determines such offerings are required, and at such time that the Company identifies a new acquisition, investment or business opportunity to be financed through SmartHeat Investment, although no specific investment candidate has been identified to date.

20. CONTINGENCIES

The Company’s operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments in China and foreign currency exchange. The Company’s results may be adversely affected by changes in PRC government policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad and rates and methods of taxation, among other things.

The Company’s sales, purchases and expense transactions in China are denominated in RMB and all of the Company’s assets and liabilities in China are also denominated in RMB. The RMB is not freely convertible into foreign currencies under the current PRC law. In China, foreign exchange transactions are required by law to be transacted only by authorized financial institutions. Remittances in currencies other than RMB may require certain supporting documentation in order to affect the remittance.

21. DISPOSAL OF SUBSIDIARIES

On December 30, 2013, the Company, closed the transaction contemplated by the EIPA dated October 10, 2013, whereby the buyers purchased 40% of the Company’s equity interests in the following PHE segment subsidiaries: Taiyu; SmartHeat Siping; SmartHeat Energy; Ruicheng; and XinRui (collectively, the “Target Companies”). The purchase price was RMB 5 million ($0.82 million). Ruicheng was 51% owned and XinRui was 46% owned by

SmartHeat US parent company prior to the 40% equity interest sale.

On November 28, 2014, the Company entered into an Amended and Restated EIPA, which amended and restated the EIPA dated October 10, 2013 between the Company and the buyers. Under the terms of the Amended EIPA, the buyers agreed to purchase the remaining 60% of the Company’s equity interests in the Target Companies effective as of December 31, 2014 (the “Closing Date”). The purchase price for the remaining 60% consisted of: (i) consideration of RMB 8.5 million ($1.39 million) and (ii) the forgiveness of all net indebtedness of $11.75 million owing to the Target Companies by SmartHeat and each of its other subsidiaries as of December 31, 2014.

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On May 11, 2015, the Company's stockholders approved the sale of all of the remaining interests, constituting 100% of its ownership interests, (the "Stock Sale") of certain subsidiaries of the Company as described above, all of the conditions precedents to the Stock Sale were satisfied which consisted of: (i) approval of its stockholders and (ii) receipt by the BOD of the Company of an opinion that the Stock Sale was fair to the stockholders of SmartHeat from a financial point of view. The parties executed a mutual release which became effective and provided, in part, that the Target Companies forgave all net indebtedness from SmartHeat and all of its other subsidiaries owing to the Target Companies. The consideration and all documents relating to the transaction were released from escrow upon the satisfaction of the foregoing conditions. The Stock Sale was effective on December 31, 2014.

The following table summarizes the FVs of the assets and liabilities disposed of as part of the sale of the remaining interests in Taiyu, SmartHeat Siping and SmartHeat Energy at the closing date of disposal. The FVs of the assets and liabilities disposed at closing date are used for the purpose of selling price allocation. The excess of the FV of the net assets disposed over the selling price of $44,032,011 was recorded as disposal loss. The Company recorded a loss of $29,540 for disposal of Ruicheng and XinRui, which was 30.6% and 27.6% owned by the Company at the closing date of disposal.

Cash and equivalents	$ 9,490,641
Restricted cash	9,847,182
Accounts receivable, net	18,437,984
Retentions receivable, net	1,206,786
Advances to suppliers, net	3,012,776
Other receivables (net), prepayments and deposits	27,205,648
Inventories	42,233,818
Notes receivable – bank acceptances	2,271,131
Noncurrent assets, net	964,865
Accounts payable	(8,106,600)
Advance from customers	(1,992,933)
Other payable and accrued expenses	(31,832,558)
Notes payable – bank acceptances	(1,401,530)
Loans payable	(25,111,702)
Disposal loss	(44,032,011)
Selling price	$ 2,193,497

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CAUTIONARY STATEMENT FOR FORWARD-LOOKING STATEMENTS

The comments made throughout this Quarterly Report should be read in conjunction with our Financial Statements and the Notes thereto, and other financial information appearing elsewhere in this document. In addition to historical information, the following discussion and other parts of this document contain certain forward-looking information. When used in this discussion, the words, “believes,” “anticipates,” “expects” and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from projected results, due to a number of factors beyond our control. We do not undertake to publicly update or revise any of our forward-looking statements, even if experience or future changes show that the indicated results or events will not be realized. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Readers are also urged to carefully review and consider our discussions regarding the various factors that affect our business, which are described in this section and elsewhere in this report, and those listed in our other SEC filings.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

On May 11, 2015 the holders of 62.3% of the outstanding common stock, par value $.0001 per share, of SmartHeat Inc., authorized the sale of all of the remaining interests, constituting 100% of its ownership interests, (the “Stock Sale”) of certain subsidiaries of the Company pursuant to the terms of an Equity Interest Purchase Agreement (the “EIPA”) dated October 10, 2013, as amended and restated on November 28, 2014 and amended on March 19, 2015 (the “Amended EIPA”), by and among Heat PHE, Inc. (“Heat PHE”), as Seller, and Hongjun Zhang, on behalf of all of several individuals (“Buyers”) identified in Buyers’ Response to RFP submitted to the Company on September 10, 2013 and as revised and accepted by Company on September 23, 2013. The subsidiaries of the Company which were sold to the Buyers were:

SmartHeat Taiyu (Shenyang) Energy;

SmartHeat Siping Beifang Energy Technology Co., Ltd.;

SmartHeat (Shenyang Energy Equipment) Co. Ltd.;

Hohhot Ruicheng Technology Co., Ltd.; and

Urumchi XinRui Technology Limited Liability Company

Upon approval by the Company’s stockholders on May 11, 2015, all of the conditions precedents in the Amended EIPA were satisfied which consisted of: (i) approval of its stockholders and (ii) receipt by the Board of Directors (“BOD”) of the Company of an opinion that the Stock Sale was fair to the stockholders of SmartHeat from a financial point of view. The parties executed a mutual release which became effective and provided, in part, that the Target Companies forgave all net indebtedness of $8.79 million owing to the Target Companies by SmartHeat and all of its other subsidiaries. The consideration and all documents relating to the transaction were released from escrow upon the satisfaction of the foregoing conditions.

The Buyers purchased 40% of Heat PHE’s equity interests in the Target Companies for a purchase price of RMB 5 million ($0.82 million) paid on December 30, 2013. The Buyers purchased the remaining 60% of Target Companies (constituting all of the remaining equity interests in the Target Companies) for purchase price of: (i) RMB 8.5 million ($1.39 million) and (ii) the forgiveness of $8.79 million in net indebtedness owing to Target Companies by SmartHeat and each of its other subsidiaries as of December 31, 2014, the date on which the sale occurred.

As a result of the Stock Sale our business has changed significantly as the significant operations of our Plated Heat Exchanges operating segment have been sold. We currently operate the Heat Pump (“HP”) operating segment with very limited sales of PHEs through SanDeKe subsidiary.

For the purposes of this Management’s Discussion and Analysis of Financial Condition and Results of Operations, descriptions regarding our current operations have been updated to reflect the Stock Sale on December 31, 2014 but include descriptions of our PHE and PHE Unit manufacturing in order to reflect our comparison of the first half year of 2015 and 2014.

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Prior to the Stock Sale, we designed, manufactured and sold clean technology plate heat exchangers ("PHE") through our PHE operating segment and related systems marketed principally in the People's Republic of China ("PRC"). Our former subsidiaries in the PHE operating segments designed, manufactured, sold and serviced PHEs, PHE Units, which combine PHEs with various pumps, temperature sensors, valves and automated control systems in systems custom designed by our in-house engineers, heat meters and heat pumps for use in commercial and residential buildings. Our former subsidiaries also designed, manufactured and sold spiral heat exchangers and tube heat exchangers. Our former subsidiaries' products and systems are an increasingly important element in providing a clean technology, mission-critical solution to energy consumption and air pollution problems in China and are commonly used in a wide variety of industrial processes where heat transfer is required. Common applications include energy conversion for heating, ventilation and air conditioning, or HVAC, and industrial use in petroleum refining, petrochemicals, metallurgy, food and beverage and chemical processing. Our former subsidiaries sell their products under the SmartHeat and Taiyu brand names and also sell PHEs under the Sondex brand name as an authorized dealer of Sondex PHEs in China.

We currently offer heat pumps in China and in Germany under the Gustrower brand name through our remaining subsidiaries. Our current HP subsidiaries design and build specific to customer specifications and particular operating conditions, known for their high quality and efficiency. Our HP operating segment subsidiaries produce heat pumps in sizes that have applications in both the industrial and residential settings. We believe our subsidiaries' HPs reduce the cost of heating and cooling by using recycled air as a heat source thereby reducing heat loss promoting energy saving and efficiency. After the Stock Sale, our HP operating segment constitutes our sole line of business.

We are a US holding company with no material assets other than the ownership interests of our subsidiaries. We were incorporated in the State of Nevada on August 4, 2006, under the name Pacific Goldrim Resources, Inc., as an exploration stage corporation with minimal operations to engage in the exploration for silver, lead and zinc. On April 14, 2008, we changed our name to SmartHeat Inc. and entered into a Share Exchange Agreement to acquire Shenyang Taiyu Machinery & Electronic Equipment Co., Ltd., subsequently renamed SmartHeat Taiyu (Shenyang) Energy Technology Co., Ltd., or Taiyu, a privately held Sino-foreign joint venture ("JV") company formed under the laws of the PRC on July 24, 2002, and engaged in the design, manufacture, sale and servicing of plate heat exchange products in China. The Share Exchange Agreement was entered into by SmartHeat, Taiyu and the shareholders of Taiyu. We received PRC government approval on May 28, 2008, of our subscription for 71.6% of the registered capital of Taiyu, and approval on June 3, 2009, of the transfer of the remaining 28.4% ownership of Taiyu from the original JV shareholders who received shares of our common stock in the Share Exchange. As a result of the Share Exchange Agreement and subsequent transactions contemplated thereby, and receipt of the above PRC government approvals, Taiyu became our wholly foreign-owned enterprise, or WFOE.

As an expansion of our business following our acquisition of Taiyu, we acquired and established subsidiaries in China and Germany.

The following chart displays our subsidiaries according to which operating segment they operated in prior to the Stock Sale:

Plate Heat Exchangers (PHE)	Heat Pumps (HP)
SmartHeat Taiyu (Shenyang) Energy Technology Co., Ltd.	SmartHeat (China) Investment Co., Ltd.
SanDeKe Co., Ltd.	SmartHeat (Shenyang) Heat Pump Technology Co., Ltd.
SmartHeat (Shenyang) Energy Equipment Co., Ltd.	SmartHeat Deutschland GmbH
SmartHeat Siping Beifang Energy Technology Co., Ltd.	SmartHeat (Shanghai) Trading Co., Ltd.
SmartHeat Heat Exchange Equipment Co.	Beijing SmartHeat Jinhui Energy Technology Co., Ltd.

As discussed above, on May 11, 2015 the Stock Sale was approved by our stockholders and we now only operate the HP segment of our business.

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Principal Factors Affecting Our Financial Performance

Prior to the 100% equity interest sale of certain subsidiaries on December 31, 2014, our PHE segment revenues were subject to fluctuations due to the timing of sales of high-value products, the impact of seasonal spending patterns, the timing and size of projects our customers perform, changes in overall spending levels in the industry, changes in PRC government fiscal policies, inflation in China and other unpredictable factors that may affect customer ordering patterns. Our revenues fluctuated due to the seasonal nature of central heating services in the PRC because the equipment used in residential buildings must be delivered prior to the beginning of the heating season in late fall, which occurs during the third and fourth calendar quarters in China. We also experienced decreased sales volume in the first calendar quarter compared to other quarters, as our customers generally install and test our products during this period, and are in the process of budgeting their new projects. Additionally, any significant delays in the commercial launch or any lack or delay of commercial acceptance of new products, unfavorable sales trends in existing product lines or impacts from the other factors mentioned above, could adversely affect our prior revenue growth or cause a decline in quarterly revenue.

The revenue of our heat pump business experiences some of the same factors impacting our historic PHE segment. The principal factors impacting the revenue of our existing business are related to China’s domestic economic and investment environments, such as the real estate market, and the quantity of real estate investment projects in China. In addition, changes in PRC government fiscal policies, inflation in China and other unpredictable factors may affect customer ordering patterns. Our revenues are expected to fluctuate due to the seasonal nature of heating services in the PRC with our peak season typically spanning July through November and reduced demand for our products in December through June. Our customers are primarily located in the Northeast, North and Northwestern regions of the PRC. Our sales are primarily impacted by a potential customer’s choice to use more energy efficient heat pump technology or less energy efficient traditional heating and cooling systems.

Our historical revenues also fluctuated significantly due to material costs; we experienced fluctuation in raw material costs as a result of world economic conditions, such as the price of stainless steel used to produce plates, our PHEs and PHE Units. We monitor the commodities markets for pricing trends and changes, but do not engage in hedging to protect against raw material fluctuations. Instead, we attempt to mitigate the short-term risks of price swings by purchasing raw materials in advance based on production needs and projected sales. We continue to experience stronger sales during the second half of the year, which is the start of fall and winter in China, during which we expect to generate the majority of our revenue. However, we believe we have more flexibility to increase and decrease our pricing of heat pumps with increases and decreases in material prices. While we historically increased our inventory and advances to suppliers during the first three quarters of each year in anticipation of our historical high season for production, we will periodically increase our heat pump raw materials if we foresee shortages. However, significant unfavorable fluctuations in the price, quality or availability of required raw materials could negatively affect our cash flows and ability to meet the demands of our customers, which could result in the loss of future sales.

Our profitability depends upon the margin between the cost of goods used in the manufacturing process, such as compressors, copper piping and wiring and other raw materials, as well as our fabrication costs associated with assembling heat pumps compared to the selling price of our products, and the overall supply of raw materials. We typically base the selling prices of our products upon the associated raw materials costs to us and labor costs. We may not be able to pass all increases in raw material costs and ancillary acquisition costs associated with taking possession of raw materials through to our customers, however, and there may be a time lag as we bid on new projects and renegotiate pricing with our existing customers. We continue to monitor our fixed costs and implement improvements to our manufacturing process to better control labor cost and improve manufacturing efficiency.

The economic conditions our subsidiaries faced in recent years, made it impossible for our subsidiaries to pay dividends to our US parent company, which is dependent upon such dividends to meet its financial obligations.

Relevant PRC statutory laws and regulations permit payments of dividends by the Company's PRC subsidiaries only out of the subsidiary's retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. Further, the Company's PRC subsidiaries are required to take certain reserves as detailed in Note 17 to our financial statements. As a result, we sought alternative sources of capital for our US parent company. On July 27, 2012, we entered into a secured, revolving credit facility with Northtech Holdings Inc., a British Virgin Islands business corporation owned by certain members of our former management, James Wang, Rhett Wang and Wen Sha. Jane Ai, our Corporate Secretary, is also a part owner of Northtech. As amended on December 21, 2012, the Credit Agreement provides for borrowings of up to $2,500,000 with any amounts borrowed due on April 30, 2014. Borrowings under the Credit Agreement are secured by 55% of the equity interest in each of our wholly, directly-owned subsidiaries and are repayable, at our option, in shares of our common stock. On December 21, 2012, we repaid $1,300,000 of the $1,384,455 outstanding under the Credit Agreement with 1,300,000 restricted shares of our common stock, approximately 22.67% of our total issued and outstanding shares of Common Stock, as authorized by the Credit Agreement and approved by our shareholders. On June 25, 2013, the Board approved second amendment to the credit and security agreement and on August 23, 2013, we entered into second amendment to the credit and security agreement with Northtech, which redefined the "base rate", and adjusted the base rate to 10%, compounded quarterly, effective January 1, 2013. On March 26, 2014, we gave notice to Northtech pursuant to the terms of the Credit and Security Agreement between the Company and Northtech, dated July 27, 2012, as amended, extending the maturity date on the Credit Agreement from April 30, 2014 to January 31, 2015. On July 14, 2014, we entered the third amendment to the Credit Agreement with Northtech; the Amendment modifies the definition of "Average Share Price" in the Credit Agreement to decrease the minimum and maximum values for the "Average Share Price," by 20% each from $0.50 to $0.40 and from $3.50 to $2.80, respectively. The Amendment also increases the maximum line which may be borrowed under the Credit Agreement from $2,500,000 to $3,250,000 and extends the maturity date for amounts borrowed from April 30, 2014 to October 31, 2015. As of June 30, 2015 and December 31, 2014, the outstanding credit line payable to Northtech was $3,384,335 and $2,749,335, respectively.

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On December 30, 2013, we closed the transaction contemplated by the EIPA dated October 10, 2013, whereby the buyers purchased 40% of the Company's equity interests in the following PHE segment subsidiaries: SmartHeat Taiyu (Shenyang) Energy; SmartHeat Siping Beifang Energy Technology Co., Ltd.; SmartHeat (Shenyang Energy Equipment) Co. Ltd.; Hohhot Ruicheng Technology Co., Ltd.; and Urumchi XinRui Technology Limited Liability Company (collectively, the "Target Companies"). The purchase price was RMB 5 million ($0.82 million). Urumchi XinRui was 46% owned by SmartHeat US parent company.

On November 28, 2014 we entered into the Amended and Restated EIPA, which amended and restated the EIPA dated October 10, 2013 between the Company and the buyers. Under the terms of the Amended EIPA, the buyers had agreed to purchase the remaining 60% of the Company's equity interests in the Target Companies effective as of December 31, 2014 (the "Closing Date"). The purchase price for the remaining 60% consisted of: (i) consideration of RMB 8.5 million ($1.39 million) and (ii) the forgiveness of all net indebtedness owed to the Target Companies by SmartHeat and each of its subsidiaries as of December 31, 2014. The effectiveness of the transaction was subject to the following conditions: (i) approval of its shareholders and (ii) receipt by the Board of Directors of the Company of an opinion that the purchase and sale transaction was fair to the shareholders of SmartHeat from a financial point of view. The parties executed a mutual release to be delivered at the closing which provide, in part, for the Target Companies to forgive all net indebtedness from SmartHeat and all of its other subsidiaries. In the event that the conditions were not met prior to December 31, 2014, the consideration and all documents were to be deposited into escrow and released when the conditions were satisfied; provided that if the conditions were not satisfied on or before March 31, 2015, either party may terminate the Amended EIPA and the funds and documents be returned to the depositing party. The termination deadline of the Amended EIPA was extended to May 15, 2015.

On May 11, 2015, the Company's stockholders approved the sale of all of the remaining interests, constituting 100% of its ownership interests, of certain subsidiaries of the Company as described above, all of the conditions precedents to the Stock Sale were satisfied which consisted of: (i) approval of its stockholders and (ii) receipt by the Board of Directors of the Company of an opinion that the Stock Sale was fair to the stockholders of SmartHeat from a financial point of view. The parties executed a mutual release which became effective and provided, in part, that the Target Companies forgave all net indebtedness from SmartHeat and all of its other subsidiaries owing to the Target Companies. The consideration and all documents relating to the transaction were released from escrow upon the satisfaction of the foregoing conditions. The Stock Sale was effective December 31, 2014.

Significant Accounting Policies

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements, we believe the following accounting policies are the most critical to aid you in fully understanding and evaluating this management discussion and analysis.

Basis of Presentation

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, or US GAAP.

Principles of Consolidation

For the six and three months ended June 30, 2015, the accompanying consolidated financial statements include SmartHeat's US parent, its subsidiaries Heat HP and Heat PHE, and their subsidiaries SanDeKe, Jinhui, SmartHeat Investment, SmartHeat Trading, SmartHeat Germany, SmartHeat Pump, and Heat Exchange, which are collectively referred to as the "Company." For the six and three months ended June 30, 2014, the accompanying consolidated financial statements include SmartHeat's US parent, its subsidiaries Heat HP and Heat PHE, and their subsidiaries

Taiyu, SanDeKe, SmartHeat Siping, Jinhui, SmartHeat Investment, SmartHeat Energy, SmartHeat Trading, SmartHeat Germany, SmartHeat Pump, and Heat Exchange. All significant intercompany accounts and transactions were eliminated in consolidation.

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Use of Estimates

In preparing the financial statements in conformity with US GAAP, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates, required by management, include the recoverability of long-lived assets, allowance for doubtful accounts, and the reserve for obsolete and slow-moving inventories. Actual results could differ from those estimates.

Accounts Receivable

We maintain reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Accounts receivable are net of unearned interest. Unearned interest represents imputed interest on accounts receivable with due dates over one year from the invoice date discounted at our borrowing rate for the year. Based on historical collection activity, we had bad debt allowances of $1.57 million and $39.26 million at June 30, 2015 and December 31, 2014, respectively.

Revenue Recognition

Our revenue recognition policies are in compliance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 605, “Revenue Recognition.” Sales revenue is recognized when PHEs, heat meters and HPs are delivered, and for PHE Units when customer acceptance occurs, the price is fixed or determinable, no other significant obligations of ours exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are recorded as unearned revenue under “Advance from customers.” As a result of 100% Stock Sale of certain subsidiaries effective December 31, 2014, the Company only sold few PHEs but was concentrating on heat pumps business for the six and three months ended June 30, 2015,

Our agreements with our customers generally provide that 30% of the purchase price is due upon placement of an order, 30% upon delivery and 30% upon installation and acceptance of the equipment after customer testing. As a common practice in the heating manufacturing business in China, payment of the final 10% of the purchase price is due no later than the termination date of the standard warranty period, which ranges from three to 24 months from the acceptance date. Due to the slowdown of the Chinese economy and tightened monetary policy, and in order to attract and retain customers, the Company’s subsidiaries have adjusted their contract and payment terms on a case-by-case basis to permit for more flexible and longer payment terms.

Our warranty is provided to all customers and is not considered an additional service; rather, it is an integral part of the product sale. We believe the existence of our product warranty in a sales contract does not constitute a deliverable in the arrangement and thus there is no need to apply FASB ASC subtopic 605-25) separation and allocation model for a multiple deliverable arrangement. FASB ASC Topic 450, “Contingencies,” specifically addresses the accounting for standard warranties FASB ASC Topic 605 does not supersede FASB ASC Topic 450. We believe that accounting for its standard warranty pursuant to FASB ASC Topic 450 does not impact revenue recognition because the cost of honoring the warranty can be reliably estimated.

We charge for after-sales services provided after the expiration of the warranty period, with after-sales services mainly consisting of cleaning PHEs and repairing and exchanging parts. We recognize such revenue when service is provided. For the six months ended June 30, 2015 and 2014, revenue from after-sales services after the expiration of the warranty period was $18,990 and $93,784, respectively. For the three months ended June 30, 2015 and 2014, revenue from after-sales services after the expiration of the warranty period was $14,833 and $47,540, respectively.

Foreign Currency Translation and Comprehensive Income (Loss)

The accounts of the US parent company are maintained in USD. The functional currency of the Company's China subsidiaries is the Chinese Yuan Renminbi ("RMB") and the functional currency of SmartHeat Germany, the Company's subsidiary in Germany, is the Euro ("EUR"). The accounts of the China subsidiaries and German subsidiary were translated into USD in accordance with FASB ASC Topic 830, "Foreign Currency Matters." According to FASB ASC Topic 830, all assets and liabilities were translated at the exchange rate on the balance sheet date; stockholders' equity was translated at the historical rates and statement of operations items were translated at the average exchange rate for the period. The resulting translation adjustments are reported under other comprehensive income in accordance with FASB ASC Topic 220, "Comprehensive Income)."

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Impairment of Long-Lived Assets

Long-lived assets, which include tangible assets, such as property and equipment and other intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable.

Recoverability of long-lived assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized based on the excess of the carrying amount over the fair value ("FV") of the assets. FV generally is determined using the asset's expected future discounted cash flows or market value, if readily determinable.

On December 30, 2013, the Company closed the transaction contemplated by the Equity Interest Purchase Agreement dated October 10, 2013, whereby certain buyers purchased 40% of the Company's equity interests in the following PHE segment subsidiaries ("Target Companies"): Taiyu, SmartHeat Siping, SmartHeat Energy, Ruicheng and XinRui for RMB5 million ($0.82 million) (See Note 1). The buyers had the option to purchase the remaining 60% equity interest in the Target Companies for an additional RMB8.5 million ($1.39 million).

According to FASB ASC Subtopic 360-10-35, a long-lived asset (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate its carrying amount may not be recoverable. As of December 31, 2013, the Company believed the following events or changes in circumstances indicated the carrying amount of its long-lived assets (asset group) were not recoverable: 1) an expectation that, more likely than not, a long-lived assets (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life, and 2) a significant decrease in the market price of a long-lived asset (asset group). Since the Company had the option to sell 100% ownership in Target Companies for RMB13.5 million ($2.21 million), a significant decrease in the market price before the end of its previously estimated useful life for their long-lived assets, the Company therefore performed asset recoverability testing by comparing the assets' estimated future undiscounted cash flows with their carrying value, and concluded the long-lived assets were not recoverable as a result of future cash flows being less than the carrying amount. The Company further calculated the impairment losses of Target Companies by determining the FV for the long-lived asset group and recorded a write-down (loss) for the difference between their carrying value and their FV. FV is an asset's purchase or sale price in a current transaction between willing parties. The best evidence of FV is prices quoted in active markets, although the Company had the option to sell 100% ownership in Target Companies for RMB13.5 million ($2.21 million), the market prices were not available for many long-lived assets such as equipment, the Company therefore used discounted cash flow method for estimating the FV of long-lived assets which are acceptable under FASB ASC Subtopic 360-10.

Based on its evaluation, the Company believed, as of December 31, 2013, the long-lived assets of Target Companies including construction in progress, property and equipment, and intangible assets were impaired for $13.73 million. In addition, the Company retained remaining 30.6% and 27.6% interest in Ruicheng and XinRui (after the 40% sale), respectively, at December 31, 2013, that was accounted for under the equity method of accounting, the Company recorded the long-term investment in Ruicheng and XinRui at FV as provided in FASB ASC Subtopic 323-10-30-2. The FV of the long-term investment was the prorated selling price for the remaining 60% equity interest that are allocated to Ruicheng and XinRui for $26,720; accordingly, the Company recorded $0.91 million impairment loss of long-term investment in Ruicheng and XinRui for the excess of the carrying amount over the FV for the year ended December 31, 2013.

Recent Accounting Pronouncements

In August 2014, the FASB issued Presentation of Financial Statements — Going Concern. This standard requires management to evaluate for each annual and interim reporting period whether it is probable that the reporting entity will not be able to meet its obligations as they become due within one year after the date that the financial statements are issued. If the entity is in such a position, the standard provides for certain disclosures depending on whether or not the entity will be able to successfully mitigate its going concern status. This guidance is effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. Early application is permitted. The Company does not anticipate that this adoption will have a significant impact on its consolidated financial position, results of operations, or cash flows.

The Financial Accounting Standards Board ("FASB") has issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers. This ASU supersedes the revenue recognition requirements in Accounting Standards Codification 605 - Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective on January 1, 2017 and should be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized at the date of initial application. In April 2015, the FASB proposed a one-year delay in the effective date and companies will be allowed to early adopt as of the original effective date. The Company is in the process of evaluating the impact of adoption of this guidance on the consolidated financial statements.

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The FASB has issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This ASU requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position and results of operations.

In February 2015, the FASB issued ASU 2015-02, “Consolidation (Topic 810) - Amendments to the Consolidation Analysis”, which provides guidance for reporting entities that are required to evaluate whether they should consolidate certain legal entities. In accordance with ASU 2015-02, all legal entities are subject to reevaluation under the revised consolidation model. ASU 2015-02 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. The Company does not anticipate that this adoption will have a significant impact on its consolidated financial position, results of operations, or cash flows.

As of June 30, 2015, there is no recently issued accounting standards not yet adopted that would have a material effect on the Company’s consolidated financial statements.

Results of Operations

Six months ended June 30, 2015 Compared to the Six months ended June 30, 2014

The following table sets forth the consolidated results of our operations for the periods indicated as a percentage of net sales, certain columns may not add due to rounding.

	2015		2014	
	$	% of Sales	$	% of Sales
Sales	$ 1,460,767		$ 1,621,431	
Cost of sales	3,021,400	207%	1,813,585	112%
Gross loss	(1,560,633)	(107)%	(192,154)	(12)%
Operating expenses	3,063,232	210%	3,314,071	204%
Loss from operations	(4,623,865)	(317)%	(3,506,225)	(216)%
Non-operating income (expenses), net	(158,212)	(11)%	322,750	20%
Income tax expense (benefit)	8,831	(0.6)%	75,493	5%
Loss from continuing operations	(4,790,908)	(328)%	(3,258,968)	(201)%
Foreign currency translation gain on sold entities	11,915,632	816%	-	-%
Loss from operations of discontinued entities, net of tax	-	-%	(3,641,237)	(225)%
Loss on disposal of discontinued entities, net of tax	(47,151,307)	(3228)%	-	-%
Less: loss attributable to noncontrolling interest from continuing operations	(16,424)	(1)%	(30,089)	(2)%

Less: loss attributable to noncontrolling interest from discontinued operations		-	-%	(1,412,208)	(87)%
Net Loss to SmartHeat Inc.	$	(40,010,159)	(2739)% $	(5,457,908)	(337)%

Sales. Net sales in the six months ended June 30, 2015, were $1.46 million, while net sales in the six months ended June 30, 2014, were $1.62 million, an overall decrease of $0.16 million or 10%. The 10% decrease in total revenue was due primarily to the temporary decrease in sales of heat pumps in the six months ended June 30, 2015, compared to the same period of 2014.

Cost of Sales. Cost of sales ("COS") was $3.02 million in the six months ended June 30, 2015, compared to $1.81 million in the comparable period of 2014, an increase of $1.21 million or 67%. The increase in our COS is attributable to increased provision for inventory impairment. COS mainly consisted of the cost of materials, factory overhead and labor. Materials cost was 37% of total cost, while factory overhead cost was 51% and labor was 12% during the six months ended June 30, 2015, The COS as a percentage of sales was 207% in the six months ended June 30, 2015 compared with 112% for the comparable period of 2014 due to increased provision for bad debts.

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We performed an inventory impairment assessment as of June 30, 2015 and December 31, 2014, for the write-down of raw materials and finished goods in inventory. We stock inventory, consisting of raw materials and finished goods, according to projected sales and customer orders, with steel plates and components for our products generally ordered two to three months in advance of anticipated production needs. As part of our impairment analysis, we performed an evaluation of raw materials stored over one year and not anticipated to be consumed, and an evaluation of potential impairment to the quality of these raw materials. If management anticipates that obsolete raw materials in inventory can be utilized and will be consumed within the next few months through new customer orders or substitute orders, no impairment is recorded. We collected information about delayed and canceled contracts and met with affected customers to discuss their financing situation and their projections of future orders. Finished goods manufactured for delayed and canceled contracts that we do not expect to be reinstated and contracts for which we have been unable to find substitute customers become impaired. We performed an evaluation of these finished goods stored over one year and recorded an impairment accordingly. We also analyzed whether to take a reserve for conversion costs of finished goods in inventory for resale to substitute customers. Following the completion of our impairment analysis, we had inventory impairment provision of $4,324,247 and $18,528,631 as of June 30, 2015 and December 31, 2014, respectively. We had inventory impairment provision of $2.04 million for the six months ended June 30, 2015, comparing with $0.14 million for the same period of 2014.

Gross Loss. Gross loss was $1.56 million in the six months ended June 30, 2015, compared to $0.19 million in the comparable period of 2014. Gross margin was (107)% and (12)% for the six months ended June 30, 2015 and 2014 respectively.

Operating Expenses. Operating expenses consisting of selling, general and administrative expenses totaled $3.06 million in the six months ended June 30, 2015, compared to $3.31 million in the comparable period of 2014, a decrease of $0.25 million or 8%. Operating expenses as a percentage of sales were 210% in the six months ended June 30, 2015, compared to 204% in the comparable period of 2014. The decrease in operating expenses was mainly due to decreased general and administrative expense of $1.32 million and no provision for advance to suppliers for the six months ended June 30, 2015, compared with $2.21 million general and administrative expense and $2.32 million provision for advance to suppliers for the six months ended June 30, 2014, although we had provisos for bad debts of $0.93 million in the six months ended June 30, 2015 comparing with a recovery of bad debts provision of $2.01 million for the six months ended June 30, 2014.

Generally, we reserve for 50% of accounts receivable with aging over 180 days and 100% of accounts receivable with aging over 360 days as bad debt allowance. We do not expect a significant risk with respect to the overdue accounts receivable for which we took the bad debt allowance and continue to work to collect all amounts due.

Non-Operating Income (Expenses), net. Our net non-operating expenses for the six months ended June 30, 2015 was $0.16 million compared to net non-operating income of $0.32 million for the comparable period of 2014, an increase of expenses of $0.48 million or 149%. The increase in non-operating expenses was due mainly to increased interest expense of $0.17 million and decreased net other income of $0.06 million for the six months ended June 30, 2015, compared to interest expense of $0.09 million and net other income of $0.45 million for the comparable period of 2014.

Loss from discontinued operations. We had loss from discontinued operations of $47.15 million with cumulative foreign currency translation gain of $11.92 million on sold entities for the six months ended June 30, 2015, compared to loss from discontinued operations of $3.64 million for the comparable period of 2014, an increase of $43.51 million or 1195%. The increase in loss from discontinued operations was mainly attributable to a loss on sale of 100% equity interest of certain subsidiaries of $35.24 million in the six months ended June 30, 2015.

Net Loss. Our net loss for the six months ended June 30, 2015, was $40.01 million compared to net loss of $5.46 million for the comparable period of 2014, an increase of $34.55 million or 633%. Net loss as a percentage of sales was 2739% in the six months ended June 30, 2015, and net loss as a percentage of sales was 337% in the comparable period of 2014. This increase in net loss was mainly attributable to loss on sale of 100% equity interest of certain subsidiaries of $35.24 million in the six months ended June 30, 2015.

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Three months ended June 30, 2015 Compared to the Three months ended June 30, 2014

The following table sets forth the consolidated results of our operations for the periods indicated as a percentage of net sales, certain columns may not add due to rounding.

	2015		2014	
	$	% of Sales	$	% of Sales
Sales	$ 683,589		$ 1,404,769	
Cost of sales	1,151,501	168%	1,535,813	109%
Gross loss	(467,912)	(68)%	(131,044)	(9)%
Operating expenses	1,679,926	246%	1,731,544	123%
Loss from operations	(2,147,838)	(314)%	(1,862,588)	(133)%
Non-operating income (expenses), net	(81,219)	(12)%	306,876	