SMARTHEAT INC.
Form 10-K
July 20, 2016

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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 001-34246

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

Nevada	98 -0514768
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

A-1, 10, Street 7
Shenyang Economic and Technological Development Zone
Shenyang, China 110141
(Address of principal executive offices)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:
Common Stock, par value $0.001 per share

Securities registered pursuant to Section 12(g) of the Act:
None

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

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ¨ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
Yes No

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

Large accelerated filer	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes No

The aggregate market value of voting common stock held by non-affiliates computed by reference to the price at which the common stock was last sold on June 30, 2015, was $0.02 per share. Accordingly, effective as of June 30, 2015, the registrant's aggregate market value was less than $50 million and the registrant qualifies for "smaller reporting company" status under Rule 12b-2 of the Exchange Act and is subject to the disclosure requirements and filing deadlines for smaller reporting companies.
As of March 31, 2016, there were 8,283,399 shares of common stock outstanding.
DOCUMENTS INCORPORATED BY REFERENCE:
None

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

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 development, financials conditions and results of operations;
- The expected growth of the market for heat pumps in China;
- 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 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 market. 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 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., unless the context indicates otherwise.

Our functional currency is the U.S. 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 Annual Report on Form 10-K 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
Item 1. Business

General

We are a U.S. holding company with no material assets other than the ownership interests of our foreign subsidiaries that design, manufacture and sell heat pumps in the People's Republic of China ("PRC") 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 primarily in industrial.

Our History

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 (the "Share Exchange Agreement"), to acquire Shenyang Taiyu Machinery & Electronic Equipment Co., Ltd., subsequently renamed SmartHeat Taiyu (Shenyang) Energy Technology Co., Ltd. ("Taiyu"), a privately held Sino-foreign joint venture company formed under the laws of the PRC on July 24, 2002, and engaged in the design, manufacture, sale and service of PHE products in China. The Share Exchange Agreement was entered into by SmartHeat, Taiyu and the shareholders of Taiyu. At the closing of the Share Exchange Agreement, all of the equitable and legal rights, title and interests in and to Taiyu's share capital of Yuan 25,000,000 were exchanged for 1,850,000 shares of SmartHeat common stock (the "Share Exchange"). 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 joint venture shareholders who had received shares of our common stock in the Share Exchange. As a result of the Share Exchange and subsequent transactions contemplated by the Share Exchange Agreement, and receipt of the above PRC government approvals, Taiyu became our wholly foreign-owned enterprise, or WFOE.

Prior to our acquisition of Taiyu, we had no interest in any property, but had the right to conduct exploration activities on 13 mineral title cells covering 27,027 hectares (66,785 acres) in the Slocan Mining Division of southeastern British Columbia, Canada. In connection with the acquisition of Taiyu, we transferred all of our pre-closing assets and liabilities (other than the obligation to pay a $10,000 fee to our audit firm) to a wholly owned subsidiary, PGR Holdings, Inc., a Nevada corporation ("SplitCo"), under the terms of an Agreement of Conveyance, Transfer and Assignment of Assets and Assumption of Obligations dated April 14, 2008. We sold all of the outstanding capital stock of SplitCo to Jason Schlombs, our former director and officer and one of our major shareholders, pursuant to a Stock Purchase Agreement dated April 14, 2008, in exchange for the return of his 250,000 shares of our common stock to us for cancellation.

As an expansion of our business following our acquisition of Taiyu, we acquired and established strategic subsidiaries in China and Germany. On September 25, 2008, we acquired SanDeKe Co., Ltd., or SanDeKe, a Shanghai-based manufacturer of PHEs. On June 16, 2009, we completed an asset purchase transaction with Siping Beifang Heat Exchanger Manufacture Co., Ltd., or Siping Beifang, to set up a new manufacturing facility under our newly incorporated subsidiary, SmartHeat Siping Beifang Energy Technology Co., Ltd., or SmartHeat Siping. On August 14, 2009, we formed Beijing SmartHeat Jinhui Energy Technology Co., Ltd., or Jinhui, a joint venture in Beijing of which we own 52%, to provide consulting services and expand our sales of PHEs into new industries and regions of China. On April 7, 2010, we formed SmartHeat (China) Investment Co., Ltd., or SmartHeat Investment, as an investment holding company in Shenyang for our investment in and establishment of new companies and businesses in China. On April 12, 2010, SmartHeat Investment formed SmartHeat (Shenyang) Energy Equipment Co., Ltd., or SmartHeat

Energy, as its wholly owned subsidiary for the research, development, manufacturing and sales of energy products. On May 6, 2010, we formed SmartHeat (Shanghai) Trading Co., Ltd., or SmartHeat Trading, through a nominee, Cleantech Holdings Inc., a British Virgin Islands company, or Cleantech Holdings, to market and expand sales of our branded products in China. Effective as of November 9, 2011, we terminated the nominee-owner relationship and acquired direct control over SmartHeat Trading. On December 2, 2010, we formed Hohhot Ruicheng Technology Co., Ltd., or Ruicheng, a joint venture in Hohhot City, China, for the design and manufacture of heat meters, of which we acquired 51% of the equity interest on January 7, 2011. On March 1, 2011, we entered into a purchase agreement to acquire 95% of the equity interests in Shenyang Bingchuan Refrigerating Machine Limited Company, a Shenyang-based state-owned heat pump manufacturer and designer subsequently renamed SmartHeat (Shenyang) Heat Pump Technology Co., Ltd., or SmartHeat Pump. On November 1, 2011, we increased the registered capital of SmartHeat Pump and thereby increased our ownership percentage to 98.8%. On March 3, 2011, we completed the acquisition of Gustrower Warmepumpen GmbH, subsequently renamed SmartHeat Deutschland GmbH, or SmartHeat Germany, a designer and manufacturer of high efficiency heat pumps in Germany, to extend our clean technology heating solutions into the rapidly growing heat pump markets in Europe and China. We subsequently transferred ownership of SmartHeat Germany to SmartHeat Pump. On April 10, 2012, we established a new joint venture named Urumchi XinRui Technology Limited Liability Company (“XinRui”), of which we own 46%.

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On December 30, 2013, SmartHeat closed a transaction contemplated by an Equity Interest Purchase Agreement dated October 10, 2013, whereby the buyers purchased 40% of the equity interests in Taiyu, SmartHeat Siping, SmartHeat Energy, Ruicheng and XinRui. The purchase price was RMB 5,000,000.

On November 28, 2014, Heat PHE entered into an Amended Equity Interest Purchase Agreement. Under the terms of the Amended EIPA Buyers agreed to purchase the remaining 60% of Target Companies (constituting all of our remaining equity interests in the companies being sold). The purchase price for the remaining 60% consists of: (i) consideration of RMB 8,500,000 and (ii) the forgiveness of all net indebtedness owing to the companies being sold by SmartHeat and each of its other subsidiaries which was $8.79 million 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 ("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.

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.

On January 20, 2016, the Company entered a Share Purchase Agreement with a series of buyers to sell 85% of the equity shares of SmartHeat Deutschland GmbH ("SmartHeat Germany") for Euro 170,000 ($185,400). SmartHeat Germany was treated as a discontinued operations in the Company's consolidated results of operations.

Our Business Segments

On August 23, 2013, the Company formed two new wholly-owned subsidiaries in the state of Nevada, Heat HP, Inc.("Heat HP") and Heat PHE, Inc. ("Heat PHE"), in order to reorganize the Company's ownership structure over its subsidiaries. On August 23, 2013, the Company entered into an assignment agreement ("Assignment Agreement") with each of Heat HP and Heat PHE which effected the reorganization. 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. The Company initially presented its financial results for the quarter ended March 31, 2013, in accordance with these operating segments and has continued segment reporting since that time.

Under the Assignment Agreement with Heat HP, the Company agreed to transfer, and in the case of indirectly owned subsidiaries, caused to be transferred, to Heat HP the following subsidiaries of the Company:

Heat HP
SmartHeat (China) Investment Co., Ltd.
SmartHeat (Shenyang) Heat Pump Technology Co., Ltd.

SmartHeat Deutschland GmbH
SmartHeat (Shanghai) Trading Co., Ltd.
Beijing SmartHeat Jinhui Energy Technology Co., Ltd.

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Under the Assignment Agreement with Heat PHE, the Company agreed to transfer, and in the case of indirectly owned subsidiaries, caused to be transferred, to Heat PHE the following subsidiaries of the Company:

Heat PHE
SmartHeat Taiyu (Shenyang) Energy Technology Co., Ltd.
SanDeKe Co., Ltd.
SmartHeat (Shenyang) Energy Equipment Co., Ltd.
SmartHeat Siping Beifang Energy Technology Co., Ltd.
Hohhot Ruicheng Technology Co., Ltd.

For financial information regarding our business segments, see Note 2 of the Notes to Consolidated Financial Statements, included in Part II, Item 8 of this report.

Sale of Equity Interests

On December 30, 2013, the Company sold 40% of the Company's equity interests in SmartHeat Taiyu (Shenyang) Energy; SmartHeat Siping Beifang Energy Technology Co., Ltd.; SmartHeat (Shenyang) Energy Equipment Co. Ltd.; Hohot Ruicheng Technology Co., Ltd.; and Urumchi XinRui Technology Limited Liability Company (collectively, the "Target Companies"). The purchase price was RMB 5,000,000. On November 28, 2014, Heat PHE entered into an Amended Equity Interest Purchase Agreement. Under the terms of the Amended EIPA Buyers agreed to purchase the remaining 60% of Target Companies (constituting all of our remaining equity interests in the companies being sold). The purchase price for the remaining 60% consists of: (i) consideration of RMB 8,500,000 and (ii) the forgiveness of all net indebtedness owing to the companies being sold by SmartHeat and each of its other subsidiaries which was $8.79 million as of December 31, 2014.

The effectiveness of the transaction was subject to the following conditions: (i) approval of its stockholders and (ii) receipt by the Board of Directors of the Company of an opinion that the sale was fair to the stockholders of SmartHeat from a financial point of view. The parties executed a mutual release, effective as of the Closing, which will provided, in part, for the companies being sold to forgive all net indebtedness from SmartHeat and all of its other subsidiaries owing to such companies as of the effective date of the Closing. On December 24, 2014, the consideration and all documents were deposited into escrow and were released upon satisfaction of the conditions. The termination deadline for 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, (the "Stock Sale"), 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 buyers consisted of 25 natural 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 Holdings Inc., the company that provided a credit line of $2.5 million to the Company.

Our Corporate Structure

Our corporate structure as of the date of this report is set forth in the following diagram. SanDeKe is a WFOE authorized by its business license to operate our businesses in China. SmartHeat Deutschland GmbH was wholly owned by Heat HP Inc. but divested on January 20, 2016.

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(1) We hold through 98.8% of the equity interest in SmartHeat Pump, with the remaining 1.2% of the equity interest held by Shenyang Economic and Technological Development Zone State-owned Assets Management Co., Ltd.
(2) We control 52% of Jinhui pursuant to a joint venture agreement entered into with the minority owner, Beijing Jun Tai Heng Rui Investment Consultancy Co. Ltd.

Our Offices

Our principal offices are located at c/o A-1, 10, Street 7, Shenyang Economic and Technological Development Zone, Shenyang, China 110141. Our telephone number is +86 (24) 2519-7699. Our website is www.smartheatinc.com. Copies of our annual, quarterly and current reports and any amendments thereto filed with or furnished to the SEC are available free of charge through our website as soon as reasonably practicable after such reports are available on the SEC website at www.sec.gov. Furthermore, a copy of this Annual Report is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. We make available free of charge on our website our Code of Conduct and the charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee.

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Recent Developments

We have lost our lease at the manufacturing facility for our heat pumps in China. We are in the process of looking for a new location. Until we locate a new location we will suspend the production of our heat pumps. We are in the process of reducing production staff but expect to retain personnel to maintain existing customers.

Products

Our subsidiaries design, manufacture, sell and service heat pumps. Its products are an increasingly important element in providing a solution to energy consumption and air pollution problems in China. Their products are used in the industrial, residential and commercial markets to make energy use more efficient and to reduce pollution by reducing the need for coal-fired boilers.

Heat pump systems provide heating, cooling and hot water for residential apartments and commercial buildings and process heat for industrial applications by moving heat between two locations using small amounts of electricity. In a typical system, heat pumps draw heat from outside air or ground to warm the inside of a home or office building. Many heat pumps have reversible cycles, too, using the same system to cool the inside of a building by transferring heat outside. Heat pumps replace conventional energy sources such as oil, gas and coal with the energy stored in water, soil and air or heat recovered from wastewater or exhaust air. By transferring heat between locations, rather than burning fuel to create a heat source, heat pumps are extremely efficient energy transfer systems. Commercial users install heat pump systems not only to reduce energy consumption but also carbon dioxide, or CO2, emissions, a trend that is encouraged by policymakers in China. The advantages of heat pumps in terms of energy efficiency, operating cost, CO2 emission reduction and their ability to provide heating and cooling in one machine has made them the leading energy source for new buildings in Germany and Austria, and has replaced conventional fossil fuel based technology in these countries to a large degree.

Heat Pump

Our subsidiaries produce heat pumps in Shenyang China. Our operations in China generally operate on an 8-hour shift, with the exception of the high season from May to November, during which we may operate for 11-12 hours per day. Production is driven by orders from clients and typically is scheduled on a just-in-time delivery basis. At this time we are looking for new production facilities.

Our subsidiaries regularly appear at industry trade shows, attending HVAC trade fairs in Shanghai and environmental protection forums in China. They also maintain positive relationships with local utilities, oil refiners, steel producers and food and beverage companies. Marketing costs generally are funded through working capital and expensed as incurred.

Components generally include pumps, valves, pipes and electronic meters purchased from a number of premium international and domestic suppliers who have been certified to meet our quality specifications. Representative component suppliers include Siemens, Wilo A.G. and Honeywell, as well as others. Our subsidiaries typically maintain a relatively small inventory of component parts for resale.

Our subsidiaries sell both directly through their sales force and through a network of national distributors located throughout China. All of their work is performed based on written contracts with customers and there are no oral contracts. Their customer base consists primarily of state-owned enterprises diversified across a number of end markets in China.

We own no patents.

Our subsidiaries compete principally in the domestic China market. We believe their competitive advantages lie in superior engineering and design skills, the longevity and efficiency of the components they use, their ability to vertically integrate their manufacturing process, their just-in-time delivery and their reliable after-sales provided through local service centers.

We expanded into the heat pump market in China and Europe with our acquisitions of SmartHeat Pump and SmartHeat Germany in 2011. The markets for heat pumps in these markets are highly fragmented. Our subsidiaries focus on the middle high-end market for heat pumps in China, competing on price and customization capabilities with foreign and joint venture producers.

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Our subsidiaries typically experience stronger sales in the third and fourth calendar quarters, which is the start of fall and winter in China. Our quarterly revenues may fluctuate significantly due to the seasonal nature of central heating services in China, where the equipment used in residential buildings must be delivered and installed prior to the beginning of the heating season in late fall.

Our business and company registrations are in compliance in all material respects with the laws and regulations of their respective governing municipal and provincial authorities. Our subsidiaries and manufacturing facilities in China are subject to the national and local laws of the PRC. Other than as described following, our subsidiaries are not subject to any other government regulations that would require them to obtain a special license or approval from the PRC government to operate their business or manufacturing facilities in China.

Our subsidiaries' are not subject to material regulation by the PRC government or other national agencies. They have obtained PRC National Safety Certification for PHE products and are ISO 9001 quality management certified, which together recognizes their commitment to safety and quality in the manufacturing processes. The European Commission has promulgated standards, such as EN 378 Safety and Environmental Requirements, for heat pumps and products sold in the European Union must carry CE marking, indicating conformity with such requirements. We believe that heat pumps sold in Europe comply with all currently applicable standards.

Our subsidiaries' manufacturing facilities in China are subject to the national environmental regulations of the PRC as well as local laws regarding pollutant discharge, air, water and noise pollution, including the Environmental Protection Law of the PRC, the Environmental Impact Appraisal Law of the PRC, the Law of the PRC on the Prevention and Control of Water Pollution, the Law of the PRC on Prevention and Control of Environmental Pollution Caused by Solid Waste, the Law of the PRC on Prevention and Control of Air Pollution and the Law of the PRC on Prevention and Control of Environmental Noise Pollution. The Environmental Protection Law of the PRC sets out the legal framework for environmental protection in the PRC. The Ministry of Environmental Protection of the PRC, or the MEP, is primarily responsible for the supervision and administration of environmental protection work nationwide and formulating national waste discharge limits and standards. Local environmental protection authorities at the county level and above are responsible for environmental protection in their jurisdictions. Companies that discharge contaminants must report and register with the MEP or the relevant local environmental protection authorities. Companies discharging contaminants in excess of the discharge limits prescribed by the central or local authorities must pay discharge fees for the excess in accordance with applicable regulations and are also responsible for the treatment of the excessive discharge. Companies that directly or indirectly discharge industrial wastewater into the water or are required by law to obtain the pollutant discharge permit before discharging wastewater or sewage shall also obtain the pollutant discharge permit.

Our subsidiaries in China have received PRC government certification of their operating facilities in China indicating that their businesses are in material compliance with the relevant PRC environmental laws and regulations. Our manufacturing subsidiaries are ISO 9001 quality management and ISO 14001 environmental management systems certified, which together recognize their development and implementation of procedures that demonstrate an ability to consistently manufacture products meeting customer specifications, environmental standards and applicable statutory and regulatory requirements. Our subsidiaries' production processes mainly generate noise, wastewater and solid wastes. They currently do not incur any material costs in connection with their compliance with the applicable PRC environmental laws as our manufacturing processes generate minimal discharge. Furthermore, the cost of maintaining compliance has not, and we believe, in the future, will not, have a material adverse effect on our business, consolidated results of operations and consolidated financial condition.

The Labor Contract Law of the PRC, effective on January 1, 2008, governs the establishment of employment relationships between employers and employees, and the conclusion, performance, termination of and the amendment to employment contracts. To establish an employment relationship, a written employment contract must be signed by the employer and employee. In the event that no written employment contract was signed at the time of establishment of an employment relationship, a written employment contract must be signed within one month after the date on which the employer first engaged the employee. The Labor Contract Law also imposes greater liabilities on employers and significantly affects the cost of an employer's decision to reduce its workforce. Further, it requires that certain terminations be based upon seniority and not merit. We believe that our subsidiaries in the PRC are in material compliance with the requirements of this law.

On June 29, 2002, the Work Safety Law of the PRC was adopted by the Standing Committee of the 9th National People's Congress and came into effect on November 1, 2002, as amended on August 27, 2009. The Work Safety Law provides general work safety requirements for entities engaging in manufacturing and business activities within the PRC. We believe our PRC subsidiaries are in material compliance with all applicable laws and regulations related to work safety.

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The principal regulations governing foreign currency exchange in China are the Foreign Exchange Administration Regulations promulgated by the State Council, as amended on August 5, 2008, or the Foreign Exchange Regulations. Under the Foreign Exchange Regulations, the RMB, the national currency of the PRC, is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the State Administration of Foreign Exchange, or the SAFE, is obtained and prior registration with the SAFE is made.

On October 21, 2005, the SAFE issued Circular 75, the Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment through Offshore Special Purpose Vehicles, which became effective as of November 1, 2005. Please refer to "Risk Factors – Risks Related to Business in China – PRC regulations relating to the registration requirements for PRC resident shareholders owning shares in offshore companies may subject our PRC resident shareholders to personal liability and limit our ability to acquire companies in China or to inject capital into our operating subsidiaries in China, limit our subsidiaries' ability to distribute profits to us or otherwise materially and adversely affect our business" for a discussion of Circular 75.

On August 29, 2008, the SAFE promulgated Circular 142, the Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises, regulating the conversion by a foreign-invested company of foreign currency into RMB by restricting how the converted RMB may be used. Please refer to "Risk Factors – Risks Related to Business in China – Restrictions on currency exchange may limit our ability to receive and use our revenues effectively" for a discussion of Circular 142.

Our ability to pay dividends is affected by the complex currency and capital transfer regulations in China that restrict the payment of dividends to us by our PRC subsidiaries. PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Our PRC subsidiaries also are required to set aside at least 10% of net income after taxes based on PRC accounting standards each year to statutory surplus reserves until the cumulative amount of such reserves reaches 50% of registered capital. These reserves are not distributable as cash dividends. Our PRC subsidiaries also may allocate a portion of their after-tax profits to their staff welfare and bonus funds, which may not be distributed to equity owners except in the event of liquidation. If any of our subsidiaries incur debt, the instruments governing the debt may restrict their ability to pay dividends or make other distributions to us.

Employees

SmartHeat does not have direct employees. However, as of December 31, 2015, SmartHeat's subsidiaries had approximately 150 full time employees. Our subsidiaries maintain strong ties with their employees and staff and retention is stable. Employee contracts in China adhere to both state and provincial employment regulations and all social security regulations. All compensation, including social insurance, is paid in a timely manner to authorities and employees. There have been no disputes to date and there are no collective bargaining agreements.

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Item 1A. Risk Factors

Our business and an investment in our securities are subject to a variety of risks. The following risk factors describe the most significant events, facts or circumstances that could have a material adverse effect upon our business, financial condition, results of operations, ability to implement our business plan, and the market price for our securities. Many of these events are outside of our control. If any of these risks actually occurs, our business, financial condition or results of operation may be materially adversely affected. In such case, the trading price of our common stock could decline and investors in our common stock could lose all or part of their investment.

Risks Related to Our Business

We are a holding company that depends on cash flow from our wholly owned subsidiaries to meet our obligations, and any inability of our subsidiaries to pay us dividends or make other payments to us when needed could disrupt or have a negative impact on our business.

After our acquisition of Taiyu in 2008, we became a holding company with no material assets other than the ownership interests of our subsidiaries through which we conduct operations. We rely on dividends paid by our subsidiaries for our cash needs, including the funds necessary to pay dividends and other cash distributions to our shareholders, to service any debt we may incur and to pay our operating expenses. China has currency and capital transfer regulations that require us to comply with complex regulations for the movement of capital. PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Our PRC subsidiaries also are required to set aside at least 10% of net income after taxes based on PRC accounting standards each year to statutory surplus reserves until the cumulative amount of such reserves reaches 50% of registered capital. These reserves are not distributable as cash dividends. Our PRC subsidiaries also may allocate a portion of their after-tax profits to their staff welfare and bonus funds, which may not be distributed to equity owners except in the event of liquidation. Furthermore, if any of our subsidiaries incur debt, the instruments governing the debt may restrict their ability to pay dividends or make other distributions to us. Accordingly, if our subsidiaries are unable to pay us dividends and make other payments to us when needed because of regulatory restrictions or otherwise, we may be materially and adversely limited in our ability to make investments or acquisitions that could be beneficial to our business, pay dividends or otherwise fund and conduct our business.

Our subsidiaries have generated losses from operations in the fiscal years ended December 31, 2014 and 2015. As such, our subsidiaries have been unable to remit funds to us for the payment of our obligations.

We do not have sufficient cash to continue as a going concern through December 2015, and our independent registered public accounting firm expressed substantial doubt regarding our ability to continue as a going concern in its audit opinion for our December 31, 2015 consolidated financial statements.

Our consolidated financial statements for the year ended December 31, 2015 have been prepared under the assumption that we will continue as a going concern. Our independent registered public accounting firm has issued their report in connection with the audit of our financial statements for the year ended December 31, 2015 that included an explanatory paragraph describing the existence of conditions that raise substantial doubt about our ability to continue as a going concern due to our liquidity. The fact that we have received this going concern qualification from our independent registered public accounting firm will likely make it more difficult for us to raise capital on favorable terms and could hinder, to some extent, our operations. We have limited capital. Because we do not have sufficient working capital for continued operations for at least the next 12 months, our continued existence is dependent upon us sustaining operating profitability or obtaining the necessary capital to meet our expenditures. The funding for our operations will primarily come from our existing line of credit with Northtech Holdings, proceeds from the proposed stock sale of our subsidiaries, as well as obtaining traditional lines of credit and loans to finance equipment, furniture, leasehold improvements and operations. Our credit line from Northtech becomes due on July 31, 2016. We cannot be assured we will have the funds to repay the outstanding principal and interest at that time. We cannot assure you that we will be able to generate sufficient sales, extend our credit terms with Northtech or raise adequate capital to meet our future working capital needs.

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Our subsidiaries acquire most components for the manufacture of their products from a limited number of suppliers, and if they are unable to obtain these components, they would experience manufacturing delays and our financial results could be adversely affected.

Our subsidiaries acquire most of the components for the manufacture of their products from a limited number of suppliers. To manufacture their products, these components must be available when needed, at the right level of quality and at the right price. If they are unable to obtain these components accordingly, they would experience delays in manufacturing their products and our financial results could be adversely affected. Suppliers of some of these components require our subsidiaries to place orders with significant lead-time to assure supply in accordance with their requirements. Certain of these suppliers are currently the sole source of one or more components upon which our subsidiaries are dependent and alternative sources would not be available for those components unless our subsidiaries were to redesign their products. Other components could be obtained from alternate suppliers without redesign, but only at higher prices than our subsidiaries currently pay or for delivery later than required by their production schedule. Our subsidiaries maintain a relatively small inventory of component parts for resale and their parts services business would suffer if the supply of replacement parts was reduced or terminated by their suppliers. If suppliers are not able to provide these critical components on the dates and at the prices scheduled, our subsidiaries may not be able to manufacture their products promptly and cost-effectively to meet customer orders, which could harm their credibility and the market acceptance and sales of their products.

Our subsidiaries may experience material disruptions to their manufacturing operations in China that could result in material delays, quality control issues, increased costs and loss of business opportunities, which may negatively impact our sales and financial results.

Our subsidiaries rely on our manufacturing facilities in China to operate our business and produce our products. While they seek to operate their facilities in compliance with applicable rules and regulations and take measures to minimize the risks of disruption at their facilities, a material disruption at one of our subsidiaries' manufacturing facilities could prevent them from meeting customer demand, reduce their sales and negatively impact our financial results. Any of their manufacturing facilities, or any of their machines within an otherwise operational facility, could cease operations unexpectedly due to a number of events, including: prolonged power failures; equipment failures; disruptions in the transportation infrastructure including roads, bridges, railroad tracks; fires, floods, earthquakes or other catastrophes; and other operational problems. Any such material disruption may prevent our subsidiaries from shipping their products on a timely basis, reduce their sales and market share and negatively impact our financial results.

We cannot be certain that our subsidiaries' product innovations will continue or that their technology will continue to satisfy the changing needs of their customers, which could result in a decrease in clients and revenue, unexpected expenses and loss of market share.

We believe that our subsidiaries' past performance has been based on, and that their future success will depend, in part, upon their ability to continue to improve their existing products through product innovation and to develop, market and produce new products. We cannot assure you our subsidiaries will be successful in introducing, marketing and producing any new products or product innovations, or that they will develop and introduce in a timely manner innovations to their existing products which satisfy customer needs or achieve market acceptance. Our subsidiaries' failure to develop new products and introduce them successfully and in a timely manner could harm our ability to grow our business and could have a material adverse effect on our business, results of operations and financial condition.

As with any technology, including the technology of our subsidiaries' current and proposed products, there are risks that the technology may not successfully address all of customers' needs. While our subsidiaries have already established successful relationships with their customers, customers needs may change or vary. This may affect the ability of our subsidiaries' present or proposed products to address all of their customers' ultimate technology needs in an economically feasible manner. Our success depends upon their ability to anticipate and respond in a timely manner to changes in the heating manufacturing industry. If they fail to identify and respond to these changes, their sales could decline and they could lose clients and market share, any of which could materially harm our business. Furthermore, if they are unable to continue to meet their clients' needs with their current product lines, they may be required to redesign existing and planned products, acquire new manufacturing equipment or incur other significant expenses.

Our subsidiaries may not be able to keep pace with rapid technological changes and competition in their industry, which could adversely impact our business, revenues and operations.

Our subsidiaries believe they have hired or engaged personnel and outside consultants who have the experience and ability necessary to help them keep pace with advances in technology in the heating manufacturing industry. While they continue to seek out and develop "next generation" technology through their research and development efforts, there is no guarantee that they will be able to keep pace with technological developments and market demands in an evolving industry and market. In addition, our subsidiaries' industry is highly competitive. Although we believe they have developed strategic relationships that will assist them to best penetrate the domestic China market, they face competition from other manufacturers of products similar to their products. Some of our competitors' advantages over our subsidiaries in the areas of products, marketing and services include: substantially greater revenues and financial resources; stronger brand names and consumer recognition; the capacity to leverage marketing expenditures across a broader portfolio of products; pre-existing relationships with potential customers; more resources to make acquisitions; lower labor and development costs; and broader geographic presence. Furthermore, our subsidiaries may experience delays in bringing new products to market, due to design, manufacturing or distribution problems. Any such delays could adversely affect their ability to compete effectively and may adversely affect their relationship with their customers. If our subsidiaries are unable to keep pace with the rapid technological changes and competition in their industry and market, our business, revenues and operations could be adversely impacted.

Our subsidiaries products may contain defects, which if subject to product liability and warranty claims, could adversely affect our subsidiaries reputation and cause us to incur significant costs.

Due to the high pressures and temperatures at which many of our subsidiaries' products are used, and the fact that some of their products are relied upon by customers or end users in their facilities or operations, or are manufactured for relatively broad consumer use, our subsidiaries face an inherent risk of exposure to claims in the event that the failure, use or misuse of our products results, or is alleged to result, in bodily injury, property damage or economic loss. We believe our subsidiaries meet or exceed existing professional specification standards recognized or required in the industries in which they operate. Despite testing, however, defects may be found in our subsidiaries' existing or new products. If they deliver products with defects, their credibility and the market acceptance and sales of their products could be harmed. Any such defects could cause them to undertake a product recall program, which would result in significant return and exchange costs, re-engineering costs, divert the attention of their engineering personnel from product development efforts and cause significant problems with customer relations and business reputation. Our subsidiaries have been subject to product liability and warranty claims in the past, none of which has had a material adverse effect on our financial condition or results of operations, and our subsidiaries may be subject to claims in the future. Although our subsidiaries currently maintain product liability coverage, which our subsidiaries believe is adequate for the continued operation of their business, such insurance may become difficult to obtain or may become unobtainable in the future on terms acceptable to our subsidiaries and may not cover warranty claims. A successful product liability claim or series of claims against our subsidiaries, including one or more consumer claims purporting to constitute class actions, in excess of our subsidiaries insurance coverage or a significant warranty claim or series of claims against our subsidiaries could materially decrease our liquidity and impair our financial condition.

Our subsidiaries could be subject to environmental liabilities in China, which could result in them incurring significant remediation costs, fines and loss of our business license.

As is the case with manufacturers of similar products, our subsidiaries use certain hazardous substances in our operations in China. Currently, their business is subject to the Environmental Protection Law of the PRC as well as other national and local laws in China regarding pollutant discharge, air, water and noise pollution. Although we believe our subsidiaries are in compliance in all material respects with the applicable PRC environmental laws and regulations, if it is determined that they are in violation of these regulations, they could be subject to financial penalties as well as the loss of their business license. Furthermore, if the national or local government in China adopts more stringent environmental regulations, our subsidiaries may incur significant costs in complying with such regulations. If our subsidiaries fail to comply with present or future environmental regulations, they may be required to pay substantial fines and remediation costs, suspend production or cease operations and may be subject to adverse publicity. Our subsidiaries currently do not incur any material costs in connection with their compliance with the applicable PRC environmental laws. However, the risk of environmental liability and charges associated with maintaining compliance with PRC environmental laws is inherent in the nature of their business, and there is no assurance that material environmental liabilities and compliance charges will not arise in the future.

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Our subsidiaries insurance coverage in China may be inadequate to protect them from potential losses.

The insurance industry in China is in its early stage of development and the business interruption insurance and the product liability insurance available currently in China offers limited coverage compared to that offered in many other countries, especially in the U.S. Any business disruption or natural disaster could result in substantial costs and a diversion of resources, which would have a material and adverse effect on our business and results of operations. Our subsidiaries in China, particularly their production facilities in Shenyang, involve risks and hazards that could result in damage to, or destruction of, property and machinery, personal injury, business interruption and possible legal liability. Our subsidiaries currently carry property and casualty insurance for their buildings, plant and equipment, but we cannot assure you that the coverage will be adequate to fully replace damage to any of the foregoing. Should any natural catastrophes such as earthquakes, floods or any acts of terrorism occur where our subsidiaries' primary operations are located and most of their employees are based, or elsewhere, our subsidiaries might suffer not only significant property damage, but also loss of revenues due to interruptions in their business operations. Our subsidiaries are unable to acquire product liability insurance in China because it is not currently available for their product lines, but our German subsidiary does maintain product liability coverage in that we believe is adequate for the continued operation of our business in Europe, but such insurance may become difficult to obtain or may become unobtainable in the future on terms acceptable to us and may not cover warranty claims. A successful product liability claim or series of claims against any of our subsidiaries, including one or more consumer claims purporting to constitute class actions, in excess of our subsidiaries' insurance coverage or a significant warranty claim or series of claims against us could materially decrease our liquidity and impair our financial condition. The occurrence of a significant event for which our subsidiaries are not fully insured or indemnified, or the failure of a party to meet its underwriting or indemnification obligations, could materially and adversely affect our operations and financial condition. Moreover, no assurance can be given that our subsidiaries will be able to maintain adequate insurance in the future at rates they consider reasonable.

Our subsidiaries' bank accounts in China are not insured or protected against loss, and the failure of any bank in which our subsidiaries deposit funds could affect their ability to continue in business.

Our subsidiaries maintain their cash in China with various national banks in China. These cash accounts are not insured or otherwise protected against loss. Should any bank holding our cash deposits become insolvent, or if our subsidiaries are otherwise unable to withdraw funds, they would lose the cash on deposit with that particular bank. Depending upon the amount of cash our subsidiaries maintain in a bank that fails, their inability to have access to such cash deposits could impair their operations, and, if they are not able to access funds to pay their suppliers, employees and other creditors, they may be unable to continue in business.

We may need additional capital to execute our business plan and fund operations and may not be able to obtain such capital on acceptable terms or at all.

In connection with the ongoing development and expansion of our business, we may incur significant expenses. We believe that we can increase our sales and net income by implementing a growth strategy that focuses on increasing sales of our subsidiaries' products in China by targeting high growth end markets and expanding sales of heat pumps in China and Europe. Management anticipates that our existing capital resources and proceeds from amounts borrowed under our Credit Agreement with Northtech will satisfy the liquidity requirements of our business until the end of 2015. However, if available funds are not sufficient to meet our current operating expenses, our plans include pursuing alternative financing arrangements, including bank loans based on our good credit rating or funds raised through offerings of our equity or debt, if and when we determine such offerings are required. Our ability to obtain additional capital on acceptable terms or at all is subject to a variety of uncertainties, including:

- Investors' perceptions of, and demand for, companies in our industry;

· Investors’ perceptions of, and demand for, companies operating in China;

· Conditions of the US and other capital markets in which we may seek to raise funds;

· Our future results of operations, financial condition and cash flows;

· Governmental regulation of foreign investment in companies in particular countries;

· Economic, political and other conditions in the US, China and other countries; and

· Governmental policies relating to foreign currency borrowings.

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There is no assurance we will be successful in locating a suitable financing transaction in a timely fashion or at all. In addition, there is no assurance we will obtain the capital we require by any other means. Future financings through equity investments are likely to be dilutive to our existing shareholders. Also, the terms of securities we may issue in future capital transactions may be more favorable for our new investors. Newly-issued securities may include preferences or superior voting rights, be combined with the issuance of warrants or other derivative securities, or be the issuances of incentive awards under equity employee incentive plans, which may have additional dilutive effects. Furthermore, we may incur substantial costs in pursuing future capital and financing, including investment banking fees, legal fees, accounting fees, printing and distribution expenses and other costs. We may also be required to recognize non-cash expenses in connection with certain securities we may issue, such as convertible notes and warrants, which will adversely impact our financial condition.

If we cannot raise additional funds on favorable terms or at all, we may not be able to carry out all or parts of our strategy to maintain our growth and competitiveness or to fund our subsidiaries' operations. If the amount of capital we are able to raise from financing activities, together with our revenues from operations, is not sufficient to satisfy our capital needs, even to the extent that we reduce our operations accordingly, we may be required to cease operations.

Our subsidiaries may be subject to claims that we have infringed the proprietary rights of others, which could require them to obtain a license or change their designs.

Although our subsidiaries do not believe any of their products infringe upon the proprietary rights of others, there is no assurance that infringement or invalidity claims, or claims for indemnification resulting from infringement claims, will not be asserted or prosecuted against them or that any such assertions or prosecutions will not have a material adverse effect on their business. Regardless of whether any such claims are valid or can be asserted successfully, defending against such claims could cause our subsidiaries to incur significant costs and could divert resources away from other activities. In addition, assertion of infringement claims could result in injunctions that prevent our subsidiaries from distributing their products. If any claims or actions are asserted against them, our subsidiaries may seek to obtain a license to the intellectual property rights that are in dispute. Such a license may not be available on reasonable terms, or at all, which could force our subsidiaries to change their designs.

If we fail to maintain an effective system of internal controls, we may not be able to report our financial results accurately. Any inability to report and file our financial results accurately and timely could harm our business and adversely affect the trading price of our common stock.

We are required to establish and maintain internal controls over financial reporting, disclosure controls and procedures and to comply with other requirements of the Sarbanes-Oxley Act and the rules promulgated by the SEC. Our management, including our President and Acting Chief Accountant, cannot guarantee our internal controls and disclosure controls will prevent all possible errors. Because of the inherent limitations in all control systems, no system of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the possibility that judgments in decision-making can be faulty and subject to simple error or mistake. Furthermore, controls can be circumvented by individual acts of some persons, by collusion of two or more persons, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, a control may become inadequate because of changes in conditions or the degree of compliance with policies or procedures may deteriorate. Because of inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. Our inability or failure to report and file our financial results accurately and timely could harm our business and the trading price of our common stock.

Our management carried out an evaluation of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting was not effective as of December 31, 2015, because of one identified material weakness in our internal control over financial reporting. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented, or detected and corrected on a timely basis. The material weakness identified relates to the lack of sufficient internal accounting personnel with appropriate levels of knowledge, experience and training in generally accepted accounting principles in the U.S., or U.S. GAAP, for the preparation of financial statements in accordance with U.S. GAAP. Furthermore, our management concluded that, as of December 31, 2015 our disclosure controls and procedures were not effective because of this identified material weakness in our internal control over financial reporting. See "Item 9A. Controls and Procedures." Our Board of Directors and management are evaluating remediation measures that we will undertake to address this material weakness and will continue this evaluation in order to implement a comprehensive remediation plan. Until such time as we hire qualified accounting staff or train our current accounting staff with the requisite U.S. GAAP experience, however, it is unlikely we will be able to remediate this material weakness in our internal control over financial reporting.

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Our accounting personnel who are primarily responsible for the preparation and supervision of the preparation of our financial statements under U.S. GAAP have limited relevant education and training in U.S. GAAP and SEC rules and regulations pertaining to financial reporting, which could impact our ability to prepare our financial statements and convert our books and records to U.S. GAAP.

Our operations principally are in China and we have maintained our books and records in accordance with generally accepted accounting principles in the PRC, or PRC GAAP. Our accounting personnel in the PRC who have the primary responsibilities of preparing and supervising the preparation of financial statements under U.S. GAAP have limited relevant education and training in U.S. GAAP and related SEC rules and regulations. As such, they may be unable to identify potential accounting and disclosure issues that may arise upon the conversion of our books and records from PRC GAAP to U.S. GAAP, which could affect our ability to prepare our financial statements in accordance with U.S. GAAP. We have taken steps to ensure that our financial statements are prepared in accordance with U.S. GAAP, including our hiring of a U.S. accounting firm to work with our PRC accounting personnel and management to convert our books and records to U.S. GAAP and prepare our financial statements. However, the measures we have taken may not be sufficient to mitigate the foregoing risks associated with the limited education and training of our accounting personnel in U.S. GAAP and related SEC rules and regulations.

Risks Related to Doing Business in China

Changes in China’s political and economic policies could have a material adverse effect on the overall economic growth of China, which could reduce the demand for our subsidiaries’ products and adversely affect our business.

Substantially all of our manufacturing and productive assets are located in China and a significant percentage of our revenue is derived from our operations in China. Accordingly, our results of operations and prospects are subject to the economic, political and legal developments in China. While China’s economy has experienced significant growth in the past twenty years, such growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures may have a negative effect on us. For example, our operating results and financial condition may be adversely affected by PRC government control over capital investments or changes in tax regulations. In recent years, the PRC government has implemented measures emphasizing the utilization of market forces for economic reform and the reduction of state ownership of productive assets, and the establishment of corporate governance in business enterprises; however, a substantial portion of productive assets in China are still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. It also exercises significant control over China’s economic growth through the allocation of resources, the control of payment of foreign currency-denominated obligations, the setting of monetary policy, the control of the housing and real estate market and the provision of preferential treatment to particular industries or companies. Any adverse change in the economic conditions or government policies in China could have a material adverse effect on the overall economic growth and level of capital expenditures in China, which in turn could lead to reduced demand for our subsidiaries’ products and consequently have a material adverse effect on our business. Furthermore, changes in policies, laws and regulations or in their interpretation or the imposition of confiscatory taxation, restrictions on currency conversion, restrictions or prohibitions on dividend payments to shareholders, or devaluations of currency could cause a decline in the price of our common stock.

We may have difficulty establishing adequate management, legal and financial controls in China, which could affect our ability to report our financial results accurately and timely.

Historically, China has not adopted an international style of management or financial reporting concepts and practices, nor modern banking, computer and other control systems. We may have difficulty in hiring and retaining a sufficient number of qualified employees to work in China. As a result of these factors, we may experience difficulty in establishing management, legal and financial controls, collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices for our subsidiaries in China that meet international standards.

If relations between the U.S. and China worsen, our business could be adversely affected and investors may be unwilling to hold or buy our stock and our stock price may decrease.

At various times during recent years, the U.S. and China have had significant disagreements over political and economic issues. Controversies may arise in the future between these two countries. Any political or trade controversies between the U.S. and China, whether or not directly related to our business, could reduce the price of our common stock.

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The nature and application of many laws of China create an uncertain environment for business operations and they could have a negative effect on our subsidiaries.

The legal system in China is a civil law system. Unlike the common law system, the civil law system is based on written statutes in which decided legal cases have little value as precedents. In 1979, China began to promulgate a comprehensive system of laws and has since introduced many laws and regulations to provide general guidance on economic and business practices in China and to regulate foreign investment. Progress has been made in the promulgation of laws and regulations dealing with economic and commercial matters, but these recently enacted laws and regulations may not cover all aspects of business activities in China sufficiently. In particular, because these laws and regulations are relatively new, the interpretation and enforcement of these laws and regulations involve uncertainties, which may limit legal protections available to our subsidiaries. In addition, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, there may be certain instances when we may not be aware of our subsidiaries violation of these policies and rules until sometime after such violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

The PRC government has enacted some laws and regulations dealing with matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. Our subsidiaries' ability to enforce commercial claims or to resolve commercial disputes under these laws and regulations is unpredictable, however, because the implementation, interpretation and enforcement of these laws and regulations is limited and, given their relative newness, involve uncertainties. For example, contracts governed by PRC law tend to contain less detail than those under U.S. law and generally are not as comprehensive in defining the rights and obligations of the contracting parties. Consequently, contracts in China are more vulnerable to disputes and legal challenges than those in the U.S. In addition, contract interpretation and enforcement in China is not as developed as in the U.S., and the result of any contract dispute is subject to significant uncertainties. Our subsidiaries currently are not subject to any contract dispute, but we cannot assure you that our subsidiaries will not be subject to future contract disputes with our suppliers, franchisees and other customers under contracts governed by PRC law, and if such disputes arise, we cannot assure you that our subsidiaries will prevail.

Furthermore, the political, governmental and judicial systems in China sometimes are impacted by corruption. There is no assurance our subsidiaries will be able to obtain recourse in any legal disputes with the suppliers, customers or other parties with whom they conduct business, if desired, through China's developing and sometimes corrupt judicial systems. Any rights our subsidiaries may have under PRC law to specific performance or to seek an injunction are severely limited, and without a means of recourse by virtue of the PRC legal system, our subsidiaries may be unable to prevent these situations from occurring. The occurrence of any such events could have a material adverse effect on our business, financial condition and results of operations.

It will be extremely difficult to acquire jurisdiction and enforce liabilities against our directors and assets based in China.

As several of our directors are citizens of the PRC, it may be difficult, if not impossible, to acquire jurisdiction over these persons in the event a lawsuit is initiated against us or our officers and directors by a shareholder or group of shareholders in the U.S. Also, because many of our operating subsidiaries and assets are located in China, it may be extremely difficult or impossible for individuals to access those assets to enforce judgments rendered against us or our directors or executive offices by U.S. courts. In addition, the courts in China may not permit the enforcement of judgments arising out of U.S. federal and state corporate, securities or similar laws. Accordingly, U.S. investors may not be able to enforce judgments against us for violation of U.S. securities laws.

Fluctuation of the Renminbi and Euro may affect our financial condition and the value of our securities.

Although we use the USD for financial reporting purposes, transactions effected by our subsidiaries in China are denominated in RMB and those by our subsidiary in Germany are denominated in EUR. The value of the RMB and EUR fluctuates and are subject to changes in the political and economic conditions in China and Europe, respectively. In particular, from June 2008 to June 2010, the RMB was pegged to the USD, but it has since been managed more flexibly. Because the PBOC regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the USD in the medium to long term. Moreover, it is possible that in the future the PRC authorities may lift restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

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Future movements in the exchange rate of the RMB could adversely affect our financial condition as substantially all of our operations and sales are transacted in RMB and we may suffer financial losses when transferring money raised outside of China into the country or paying vendors for services performed outside of China. Historically, we have not engaged in hedging activities to mitigate this risk of fluctuating exchange rates and have no current intention of doing so. Moreover, fluctuations in the exchange rate between the USD and RMB will affect our financial results reported in USD terms without giving effect to any underlying change in our business, financial condition or results of operations. The value of our common stock likewise will be affected by the foreign exchange rate between the USD and RMB, and between those currencies and other currencies in which our sales may be denominated. Fluctuations in the exchange rate will also affect the relative value of any dividend we may issue in the future that will be exchanged into USD and earnings from, and the value of, any USD-denominated investments we make in the future. For example, if we need to convert USD into RMB for our operational needs and the RMB appreciates against the USD at that time, our financial position, our business and the price of our common stock may be harmed. Conversely, if we decide to convert our RMB into USD for the purpose of declaring dividends on our common stock or for other business purposes and the USD appreciates against the RMB, the USD equivalent of our earnings from our subsidiaries in China would be reduced.

PRC regulations relating to mergers, offshore companies and PRC shareholders, if applied to us, may limit our ability to operate our business as we see fit.

PRC regulations govern the process by which we may participate in an acquisition of assets or equity interests and may make loans and direct investments to our subsidiaries in China. Depending on the structure of the transaction, these regulations require involved parties to make a series of applications and supplemental applications to various government agencies. In some instances, the application process may require the presentation of economic data concerning a transaction, including appraisals of the target business and evaluations of the acquirer, which are designed to allow the government to assess the transaction. Government approvals will have expiration dates by which a transaction must be completed and reported to the government agencies. Compliance with the new regulations is likely to be more time consuming and expensive than in the past and the government can now exert more control over the combination of two businesses. Accordingly, due to PRC regulations, our ability to engage in business combination transactions in China through our PRC subsidiaries has become significantly more complicated, time consuming and expensive, and we may not be able to negotiate transactions that are acceptable to us or sufficiently protective of our interests. Furthermore, loans and capital contributions from an offshore holding company such as us to its subsidiaries in China are subject to PRC regulations and approval. For example, loans by us to our subsidiaries in China, which are foreign-invested enterprises, to finance their activities cannot exceed statutory limits and must be registered with the SAFE. Similarly, the PRC Ministry of Commerce, or MOFCOM, or its local counterpart must approve any capital contribution by us to our PRC subsidiaries. We cannot assure you that we will be able to obtain these government approvals on a timely basis, if at all, with respect to future loans or capital contributions by us to our subsidiaries.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

The RMB is currently convertible under the “current account,” which includes dividends, trade and service-related foreign exchange transactions, but not under the “capital account,” which includes foreign direct investment and loans. Currently, our subsidiaries in China may purchase foreign currencies for settlement of current account transactions, including payments of dividends to us, without the approval of the SAFE. However, the relevant PRC government authorities may limit or eliminate their ability to purchase foreign currencies in the future. Since a significant amount of our future revenues will be denominated in RMB, any existing and future restrictions on currency exchange may limit our ability to utilize revenues generated in RMB to fund our business activities outside China that are denominated in foreign currencies.

On August 29, 2008, the SAFE promulgated Circular 142, the Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises, to regulate the conversion by foreign-invested enterprises, or FIEs, of foreign currency into RMB by restricting how the converted RMB may be used. Circular 142 requires that RMB converted from the foreign currency-dominated capital of a FIE may only be used for purposes within the business scope approved by the applicable government authority and may not be used for equity investments within the PRC unless specifically provided for otherwise. In addition, the SAFE strengthened its oversight over the flow and use of RMB funds converted from the foreign currency-dominated capital of a FIE. The use of such RMB may not be changed without approval from the SAFE, and may not be used to repay RMB loans if the proceeds of such loans have not yet been used. These limitations could affect the ability of our subsidiaries in China to obtain foreign exchange through debt or equity financing.

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If the China Securities Regulatory Commission, or CSRC, or another PRC regulatory agency determines that its approval is required in connection with our public offerings, we may become subject to penalties.

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the Regulation on Mergers and Acquisitions of Domestic Companies by Foreign Investors, or the M&A Regulations, which became effective on September 8, 2006. The M&A Regulations, among other things, have certain provisions that require offshore special purpose vehicles, or SPVs, formed for the purpose of acquiring PRC domestic companies and controlled by PRC individuals, to obtain the approval of the CSRC prior to listing their securities on an overseas stock exchange. We believe, based on the opinion of our PRC legal counsel, the Beijing Rondos Law Firm, that while the CSRC generally has jurisdiction over overseas listings of SPVs like us, CSRC's approval is not required for the offerings of our securities because our current corporate structure was established before the new regulation became effective. However, there remains some uncertainty as to how this regulation will be interpreted or implemented in the context of an overseas offering. If the CSRC or another PRC regulatory agency subsequently determines that its approval is required for our public offerings, we may face sanctions by the CSRC or another PRC regulatory agency. If this happens, these regulatory agencies may impose fines and penalties on our operations in the PRC, limit our operating privileges in the PRC, delay or restrict the repatriation of the proceeds from our public offerings into the PRC, restrict or prohibit payment or remittance of dividends by our PRC subsidiaries to us or take other actions that could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our ordinary shares.

We operate in the PRC through our operating entities whose foreign-investment status has been approved by the local offices of MOFCOM. If MOFCOM subsequently determines that such approval procedures have not been completely satisfied for our foreign-invested enterprises, we may lose the WFOE status of certain of our subsidiaries, which could negatively impact our business in China.

Our operating entities in the PRC have received approval from their respective local offices of MOFCOM as WFOEs and foreign-invested joint ventures. We believe we have satisfied all MOFCOM approval procedures for having obtained such status, but there may be conditions subsequent to complete and maintain such status. In particular, we believe that our acquisition of Taiyu, a privately held Sino-foreign joint venture company, in 2008 was not subject to the 2006 M&A Regulations but instead the 1997 Provisions on Changes in Equity Interest of Foreign Investment Enterprises, which do not require the approval of MOFCOM's central office in connection with the acquisition of interests in a foreign-invested entity operating in an industry not restricted or prohibited under PRC law. The meaning of many of the provisions of the M&A Regulations is still unclear, however, and PRC regulators have wide latitude in the enforcement of these and other relevant regulations. Consequently, the MOFCOM approval procedures or interpretations of its approval procedures may be different from our understanding or may change. If MOFCOM subsequently determines that we should have obtained the approval of MOFCOM's central office for our investments in any or all of our PRC foreign-invested subsidiaries, we may need to apply for a remedial approval or waiver of such approval requirements, and may be subject to certain administrative punishments or other sanctions from PRC regulatory agencies. As a result, if we lose the WFOE status of any of our PRC operating subsidiaries for any reason, there may be a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our shares of common stock.

PRC regulations relating to the registration requirements for PRC resident shareholders owning shares in offshore companies may subject our PRC resident shareholders to personal liability and limit our ability to acquire companies in China or to inject capital into our operating subsidiaries in China, limit our subsidiaries' ability to distribute profits to us or otherwise materially and adversely affect our business.

The SAFE issued a public notice in October 2005, Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment through Offshore Special Purpose Vehicles, which we refer to as Circular 75, requiring PRC residents, including both legal persons and natural persons, to register with the competent local SAFE branch before establishing or controlling any company outside of China, referred to as an "offshore special purpose company," for the purpose of acquiring any assets of or equity interest in PRC companies and raising funds from overseas. In addition, any PRC resident who is the shareholder of an offshore special purpose company is required to amend his or her SAFE registration with the local SAFE branch, with respect to that offshore special purpose company in connection with any increase or decrease of capital, transfer of shares, merger, division, equity investment or creation of any security interest over any assets located in China. If any PRC resident who is the shareholder of an offshore special purpose company fails to comply with the SAFE registration requirements, the PRC subsidiaries of the offshore special purpose company may be prohibited from distributing their profits and proceeds from any reduction in capital, share transfer or liquidation to their offshore parent company and the offshore parent company may be restricted in its ability to contribute additional capital into its PRC subsidiaries. Moreover, failure to comply with the SAFE registration requirements could result in liabilities under PRC laws for evasion of foreign exchange restrictions. Although we believe that our PRC subsidiaries are in compliance with these regulations, should these regulations or the interpretation of them by course or regulatory agencies change, we may not be able to pay dividends outside of China. We do not believe that we have incurred a liability because of noncompliance with Circular 75 under SAFE registration procedures, however. Accordingly, we cannot predict fully how Circular 75 will affect our business operations or future strategies because of ongoing uncertainty over how Circular 75 is interpreted and implemented, and how or whether SAFE will apply it to us.

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We have requested our PRC resident beneficial owners, including our former Chairman and Chief Executive Officer, to make the necessary applications, filings and amendments as required under SAFE regulations in connection with their equity interests in us and our acquisitions of equity interests in our PRC subsidiaries. We cannot provide any assurances that all of our present or prospective direct or indirect PRC resident beneficial owners have or will comply fully with all applicable registrations or required approvals. The failure or inability of our PRC resident beneficial owners to comply with the applicable SAFE registration requirements may subject these beneficial owners or us to fines, legal sanctions and restrictions described above.

On March 28, 2007, SAFE promulgated the Operating Procedures for Foreign Exchange Administration of Domestic Individuals Participating in Employee Stock Ownership Plans and Stock Option Plans of Offshore Listed Companies, or Circular 78. Under Circular 78, PRC citizens granted stock options by an offshore listed company are required, through an agent in China or a PRC subsidiary of the offshore listed company, to register with SAFE and complete certain other procedures, including applications for foreign exchange purchase quotas and opening special bank accounts. Failure to comply with these regulations may subject us or our PRC employees that receive stock option grants from us to fines and legal sanctions imposed by SAFE or other PRC government authorities and may prevent us from further granting stock options under our equity incentive plans to our PRC-citizen employees in China. Such events could adversely affect our business operations.

PRC labor laws may adversely affect our results of operations.

On June 29, 2007, the PRC government promulgated the Labor Contract Law of the PRC, effective on January 1, 2008, to govern the establishment of employment relationships between employers and employees, and the conclusion, performance, termination of and the amendment to employment contracts. The Labor Contract Law imposes greater liabilities on employers and significantly affects the cost of an employer’s decision to reduce its workforce. Further, it requires that certain terminations be based upon seniority and not merit. In the event our subsidiaries decide to significantly change or decrease their workforce in China, the Labor Contract Law could adversely affect their ability to effect such changes in a manner that is most advantageous to our business or in a timely and cost-effective manner, thus materially and adversely affecting our financial condition and results of operations.

Under the Enterprise Income Tax Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC resident shareholders.

China passed the Enterprise Income Tax Law, or the EIT Law, and its implementing rules, both of which became effective on January 1, 2008. Under the EIT Law, an enterprise established outside of China with “de facto management bodies” within China is considered a “resident enterprise,” meaning that it must be treated as a PRC domestic enterprise for enterprise income tax purposes. The implementing rules of the EIT Law define de facto management as “substantial and overall management and control over the production and operations, personnel, accounting, and properties” of the enterprise.

On April 22, 2009, the PRC State Administration of Taxation, or the SAT, issued the Notice Concerning Relevant Issues Regarding Cognizance of Chinese Investment Controlled Enterprises Incorporated Offshore as Resident Enterprises pursuant to Criteria of de facto Management Bodies, or the Notice, further interpreting the application of the EIT Law and its implementation regarding non-PRC enterprise or group controlled offshore entities. Pursuant to the Notice, an enterprise incorporated in an off-shore jurisdiction and controlled by a PRC enterprise or group will be classified as a “non-domestically incorporated resident enterprise” if: (i) its senior management in charge of daily operations reside or perform their duties mainly in China; (ii) its financial or personnel decisions are made or approved by bodies or persons in China; (iii) its substantial assets and properties, accounting books, corporate chops, board and shareholder minutes are kept in China; and (iv) at least half of its directors with voting rights or senior management often reside in China. A “resident enterprise” would be subject to an enterprise income tax rate of 25% on its worldwide income and must pay a withholding tax at a rate of 10% when paying dividends to its non-PRC shareholders. However, detailed measures on imposition of tax from non-domestically incorporated resident enterprises are not yet available. Therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

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We may be deemed to be a “resident enterprise” by PRC tax authorities. If the PRC tax authorities determine that we are a “resident enterprise” for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to the enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest on financing proceeds and non-China source income would be subject to PRC enterprise income tax at a rate of 25%. Second, although under the EIT Law and its implementing rules dividends paid to us from our PRC subsidiaries would qualify as “tax-exempt income,” we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as “resident enterprises” for PRC enterprise income tax purposes. Finally, it is possible that future guidance issued with respect to the new “resident enterprise” classification could result in a situation in which a 10% withholding tax is imposed on dividends we pay to our non-PRC shareholders and with respect to gains derived by our non-PRC shareholders from transferring our shares. If we were treated as a “resident enterprise” by PRC tax authorities, we would be subject to taxation in both the U.S. and China, and our PRC tax may not be creditable against our U.S. tax.

Dividends distributed from our PRC subsidiaries to our non-PRC resident shareholders would be subject to U.S. and PRC withholding taxes.

We are a Nevada holding company and substantially all of our income is derived from dividends we receive from our subsidiaries, including those in China. Pretax earnings of a foreign subsidiary are subject to U.S. taxation when effectively repatriated. We currently consider the undistributed earnings of our PRC subsidiaries to be invested indefinitely and, accordingly, record no deferred U.S. tax expense on such earnings. If our PRC subsidiaries were to distribute dividends to us, the dividends would be subject to U.S. and PRC withholding taxes. Before the EIT Law came into effect on January 1, 2008, dividends paid to foreign investors by FIEs, such as dividends paid to us by our subsidiaries in China, were exempt from PRC withholding tax. Pursuant to the EIT Law, dividends generated after January 1, 2008, and distributed to us by our subsidiaries in China are subject to withholding tax at a rate of 5%, provided that we are determined by the relevant PRC tax authorities to be a “non-resident enterprise” under the EIT Law and hold at least 25% of the equity interest of our subsidiaries. If we are determined to be a “resident enterprise,” we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as “resident enterprises” for PRC enterprise income tax purposes.

The SAT promulgated “Notice on How to Understand and Determine the Beneficial Owners in Tax Agreement” on October 27, 2009, or SAT Circular 601, which provides guidance for determining whether a resident of a contracting state is the “beneficial owner” of an item of income under China’s tax treaties and tax arrangements. According to SAT Circular 601, a beneficial owner generally must be engaged in substantive business activities. An agent or conduit company will not be regarded as a beneficial owner and, therefore, will not qualify for treaty benefits. The agent or conduit company normally refers to a company that is registered in a jurisdiction other than China and merely meets the minimum legal requirements on organizational form and is not engaged in substantive operational activities for manufacturing, distribution or management. It is still unclear how SAT Circular 601 is implemented by SAT or its local counterparts in practice and whether we could be recognized as a “beneficial owner.” If we are deemed a non-resident enterprise but not qualified as a beneficial owner, we will not be entitled to a reduced 5% withholding tax and the 10% withholding tax would be imposed on any dividend income received from our subsidiaries in China. As a result, our net income would be reduced and our operating results would be adversely affected.

Tax laws and regulations in China are subject to revision, some of which may adversely affect our profitability, and the termination of certain preferential tax treatment for which our subsidiaries are eligible in China may adversely affect our net income.

The PRC corporate tax regime continues to undergo revision. Tax benefits that our subsidiaries presently enjoy may not be available to us in the wake of these changes, and our subsidiaries could incur tax obligations to the PRC government that are significantly higher than currently anticipated. These increased tax obligations could negatively affect our financial condition and our revenues, gross margins, profitability and results of operations may be adversely affected as a result.

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Our compliance with the Foreign Corrupt Practices Act may put our subsidiaries at a competitive disadvantage, while our failure to comply with the Foreign Corrupt Practices Act may result in substantial penalties.

We are required to comply with the United States Foreign Corrupt Practices Act, or the FCPA, which prohibits U.S. companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Although we inform our subsidiaries' personnel that such practices are illegal, we cannot assure you that our subsidiaries' employees or other agents will not engage in such conduct for which we might be held responsible. If our subsidiaries' employees or other agents are found to have engaged in such practices, we could suffer severe penalties. Non-U.S. companies, including some of our subsidiaries' competitors, are not subject to the provisions of the FCPA. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time to time in mainland China. If our subsidiaries' competitors engage in these practices, they may receive preferential treatment from personnel of some companies, giving our subsidiaries' competitors an advantage in securing business or from government officials who might give them priority in obtaining new licenses, which would put our subsidiaries at a disadvantage.

Risks Related to Our Securities

The application of the "penny stock" rules could adversely affect the market price of our common stock and increase your transaction costs to sell those shares.

Our common stock may be subject to the "penny stock" rules adopted under Section 15(g) of the Exchange Act. The penny stock rules apply to issuers whose common stock does not trade on a national securities exchange and trades at less than $5.00 per share, or that have a tangible net worth of less than $5,000,000 ($2,000,000 if the company has been operating for three or more years). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from those rules, to deliver a standardized risk disclosure document prepared by the SEC that contains the following information:

- A description of the nature and level of risk in the market for penny stocks in both public offerings and secondary trading;

- A description of the broker's or dealer's duties to the customer and of the rights and remedies available to the customer with respect to violation to such duties or other requirements of securities laws;

- A brief, clear, narrative description of a dealer market, including "bid" and "ask" prices for penny stocks and the significance of the spread between the "bid" and "ask" prices;

- A toll-free telephone number for inquiries on disciplinary actions;

- Definitions of any significant terms in the disclosure document or in the conduct of trading in penny stocks; and

- such other information and is in such form (including language, type, size and format), as the SEC shall require by rule or regulation.

Prior to effecting any transaction in a penny stock, the broker-dealer also must provide the customer with the following information:

- Bid and offer quotations for the penny stock;

- Compensation of the broker-dealer and our salesperson in the transaction;

- Number of shares to which such bid and ask prices apply, or other comparable information relating to the depth and liquidity of the market for such stock; and

- Monthly account statements showing the market value of each penny stock held in the customer's account.

The penny stock rules further require that, prior to a transaction in a penny stock not otherwise exempt from those rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written acknowledgment of the receipt of a risk disclosure statement, a written agreement to transactions involving penny stocks and a signed and dated copy of a written suitability statement.

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Due to the requirements of the penny stock rules, many broker-dealers have decided not to trade penny stocks. As a result, the number of broker-dealers willing to act as market makers in such securities is limited. If we remain subject to the penny stock rules for any significant period, it could have an adverse effect on the market, if any, for our securities. Moreover, if our securities are subject to the penny stock rules, investors will find it more difficult to dispose of our securities.

The market price for our common stock may be volatile, which could make it more difficult or impossible for you to sell our common stock for a positive return on your investment.

The trading price of our common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include, but are not limited to, our quarterly operating results or the operating results of other companies in our industry, announcements by us or our competitors of acquisitions, new products, product improvements, commercial relationships, intellectual property, legal, regulatory or other business developments and changes in financial estimates or recommendations by stock market analysts regarding us or our competitors. In addition, the stock market in general, and in particular the market for companies with substantial operations based in China, that became public by means of a reverse acquisition with a public shell company or that recently effected a reverse stock split, has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated or disproportionate to their operating performance. These broad market fluctuations may have a material adverse effect on our stock price, regardless of our operating results. Further, the market for our common stock is limited and we cannot assure you that a larger market will ever be developed or maintained. Market fluctuations and volatility, as well as general economic, market and political conditions, could reduce our market price. As a result, these factors may make it more difficult or impossible for you to sell our common stock for a positive return on your investment.

Our quarterly results may be volatile, which could materially affect the per share price of our common stock.

Our operating results have varied on a quarterly basis during our operating history and are likely to fluctuate significantly in the future. Many factors, including the risk factors incorporated by reference herein, could cause our revenues and operating results to vary significantly in the future. Many of these factors are outside of our control. Accordingly, we believe that quarter-to-quarter comparisons of our operating results are not necessarily meaningful. Investors should not rely on the results of one quarter as an indication of our future performance. If our results of operations in any quarter do not meet analysts’ expectations, our stock price could materially decrease.

Future sales of our stock could depress the market price of our common stock and cause our stock price to decline.

Future sales of shares of our common stock could adversely affect the prevailing market price of our stock. If our significant stockholders sell a large number of shares, or if we issue a large number of shares, the market price of our common stock could significantly decline. Moreover, the perception in the public market that our significant stockholders might sell shares of our common stock could depress the market for our shares. If such shareholders sell substantial amounts of our common stock in the public market, such sales could create a circumstance commonly referred to as an “overhang,” in anticipation of which the market price of our common stock could fall. The existence of an overhang, whether or not sales have occurred or are occurring, also could make it more difficult for us to raise additional financing through the sale of equity or equity-related securities in the future at a time and price we deem reasonable or appropriate.

We may issue additional shares of our capital stock or debt securities to raise capital or complete acquisitions, which would reduce the equity interest of our stockholders.

Our Articles of Incorporation authorize the issuance of up to 75,000,000 shares of common stock, par value $0.001 per share. As of Although we have no commitments as of the date of this report to issue our securities, we may issue a substantial number of additional shares of our common stock to complete a business combination, to raise capital or to repay outstanding debt obligation, including amounts we may borrow under the Credit Agreement with Northtech. The issuance of additional shares of our common stock may significantly reduce the equity interest of our existing stockholders and may adversely affect prevailing market prices for our common stock.

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We have not paid dividends in the past and do not expect to pay dividends in the future. Any return on investment may be limited to the value of our common stock.

We have never paid cash dividends on our common stock and do not anticipate doing so in the foreseeable future. The payment of dividends on our common stock will depend on earnings, financial condition and other business and economic factors affecting it at such time as the Board of Directors may consider relevant. Furthermore, China has currency and capital transfer regulations that require us to comply with complex regulations for the movement of capital. See "Risks Related to Our Business – We are a holding company that depends on cash flow from our wholly owned subsidiaries to meet our obligations." Although our management believes that we are in compliance with these regulations, should these regulations or the interpretation of them by PRC courts or regulatory agencies change, we may not be able to pay dividends to our shareholders outside of China. Our management intends to follow a policy of retaining all of our earnings to finance the development and execution of our strategy and the expansion of our business. If we do not pay dividends, our common stock may be less valuable because a return on your investment will only occur if our stock price appreciates.

Provisions in the Nevada Revised Statutes and our Articles of Incorporation and Amended and Restated Bylaws could make it very difficult for you to bring any legal actions against our directors or officers for violations of their fiduciary duties or could require us to pay any amounts incurred by our directors or officers in any such actions.

Members of our Board of Directors and our officers will have no liability for breaches of their fiduciary duty of care as a director or officer, except in limited circumstances, pursuant to provisions in the Nevada Revised Statutes and our Articles of Incorporation and Amended and Restated Bylaws as authorized by the Nevada Revised Statutes. Specifically, Section 78.138 of the Nevada Revised Statutes provides that a director or officer is not individually liable to the company or its shareholders or creditors for any damages as a result of any act or failure to act in his or her capacity as a director or officer unless it is proven that (1) the director's or officer's act or failure to act constituted a breach of his or her fiduciary duties as a director or officer and (2) his or her breach of those duties involved intentional misconduct, fraud or a knowing violation of law. This provision is intended to afford directors and officers protection against and to limit their potential liability for monetary damages resulting from suits alleging a breach of the duty of care by a director or officer. Accordingly, you may be unable to prevail in a legal action against our directors or officers even if they have breached their fiduciary duty of care. In addition, our Amended and Restated Bylaws allow us to indemnify our directors and officers from and against any and all costs, charges and expenses resulting from their acting in such capacities with us. This means that if you were able to enforce an action against our directors or officers, in all likelihood, we would be required to pay any expenses they incurred in defending the lawsuit and any judgment or settlement they otherwise would be required to pay. Accordingly, our indemnification obligations could divert needed financial resources and may adversely affect our business, financial condition, results of operations and cash flows, and adversely affect prevailing market prices for our common stock.

Item 1B. Unresolved Staff Comments

Not required.

Item 2. Properties

Our headquarters and principal manufacturing facilities are located in the Shenyang Economic and Technological Development Zone, Shenyang City, Liaoning Province, PRC. We currently do not have any manufacturing facilities. We are seeking new manufacturing facilities.

Item 3. Legal Proceedings

We may become involved in various lawsuits and legal proceedings arising in the ordinary course of business. Litigation is subject to inherent uncertainties and an adverse result in these or other matters may arise from time to time that may have an adverse effect on our business, financial conditions or operating results. Aside from the proceeding described below, we are currently not aware of any such legal proceedings or claims that will have, individually or in the aggregate, a material adverse effect on our business, financial condition or operating results.

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On August 31, 2012, a putative class action lawsuit, Steven Leshinsky v. James Wang, et. al., which purported to allege federal securities law claims against the Company and certain of its former officers and directors, was filed in the United States District Court for the Southern District of New York. Thereafter, two plaintiffs filed competing motions to be appointed lead plaintiff in the proceeding. A lead plaintiff was appointed and an amended complaint was filed on January 28, 2013, by the Rosen Law Firm. The amended complaint included Oliver Bialowons, our President, and Michael Wilhelm, our former Chief Financial Officer, as defendants in the proceeding though they were not officers of the Company during the alleged class period. A second amended complaint was filed on April 8, 2013, under the caption Stream Sicav, Dharanendra Rai et al. v. James Jun Wang , SmartHeat, Inc. et al., removing Messrs. Wilhelm and Bialowons as defendants. The second amended complaint alleges two counts against the Company, both asserting violations of the federal securities laws arising from alleged insider sales or management sales of securities and alleged false disclosures relating to those sales. On May 8, 2013, the Company filed a motion to dismiss the second amended complaint which was denied. On March 17, 2014 the court, denied, the lead plaintiff's motion for class certification, without prejudice. On August 6, 2014, the lead plaintiff once again filed a motion for class certification. On September 19, 2014, the Company filed an opposition to the lead plaintiff’s motion for class certification, to which plaintiff filed a response on October 20, 2014. By Opinion and Order dated January 21, 2015, the Court denied plaintiffs’ class certification motion, finding that it failed to satisfy the requirements of Fed. R. Civ. Pro. 23 for typicality, adequacy and predominance. Specifically, the Court found that plaintiffs’ theory of liability required a trade-by-trade inquiry as to whether the sale of the locked-up shares resulted in price inflation of the company’s stock, and that, as a result, the injury to all class members could not be established by common proof. In addition to finding a lack of predominance of common issues, the Court expressed substantial concerns about the adequacy of the class representative, and that his claims were typical of other class members. The Court also expressed doubts as to how plaintiffs would establish damages. The Court’s denial of class certification was without prejudice, and the Court gave plaintiffs until February 17, 2015 to file a “far more rigorous, and a far more convincing submission…”. The pleadings and court orders are publicly available.

The Company entered into an agreement to settle all claims in a US securities class action lawsuit. No findings of any wrongdoings were ever made against SmartHeat, any current or former officer or director of Smartheat or any of the defendants, and the Company and all other defendants continue to deny any wrongdoing. The default judgment previously entered against James Jun Wang was vacated and was dismissed with prejudice. The Company entered into the settlement in order to avoid further cost of defending any of the purported actions. According to the settlement, the Company paid the plaintiffs $120,000. In return, the plaintiffs dismissed all claims against the Company and all of the individual defendants with prejudice. As a result of the settlement, the case will not be allowed to be re-filed.

The settlement is not an admission of wrongdoing or acceptance of fault by the Company or any of the individual defendants. The Company has and continues to assert that the allegations made in the consolidated lawsuits lack merit and no evidence was ever asserted supporting the allegations made in the consolidated lawsuits. The Company has nevertheless agreed to the settlement in order to eliminate the uncertainties, burden and expense of further litigation. The Company believes that putting this matter behind it is in the best interest of its customers, employees and shareholders so that it can remain focused on growing and strengthening its business.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

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

Market Information

Our common stock has traded on the over the counter market since November 9, 2012. Previously, and prior to NASDAQ halting trading in our common stock, our common stock was listed on the NASDAQ Global Select Market under the symbol "HEAT" and had been trading on NASDAQ since January 29, 2009. The following table sets forth the range of the high and low sales prices of our common stock for each quarter in the years ended December 31, 2014 and 2015.

	2015		2014	
	High	Low	High	Low
First Quarter (through March 31)	$.14	.05	$0.30	$0.05
Second Quarter (through June 30)	.05	.02	0.25	0.10
Third Quarter (through September 30)	.02	.001	0.29	0.05
Fourth Quarter (through December 31)	.01	.0001	0.18	0.01

Holders of Record

On March 31, 2016, there were approximately 56 shareholders of record based on information provided by our transfer agent. Many of our shares of common stock are held in street or nominee name by brokers and other institutions on behalf of shareholders and we are unable to estimate the total number of shareholders represented by these record holders.

Dividend Policy

We have not paid and do not expect to declare or pay any cash dividends on our common stock in the foreseeable future, and we currently intend to retain future earnings, if any, to finance the expansion of our business. The decision whether to pay cash dividends on our common stock will be made by our Board of Directors, in their discretion, and will depend on our financial condition, operating results, capital requirements and other factors deemed relevant by our Board of Directors.

Our ability to pay dividends may be affected by the complex currency and capital transfer regulations in China that restrict the payment of dividends to us by our subsidiaries in China. PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Our subsidiaries in China also are required to set aside at least 10% of net income after taxes based on PRC accounting standards each year to statutory surplus reserves until the cumulative amount of such reserves reaches 50% of registered capital. These reserves are not distributable as cash dividends. Our subsidiaries in China also may allocate a portion of their after-tax profits to their staff welfare and bonus funds, which may not be distributed to equity owners except in the event of liquidation. If any of our subsidiaries incur debt, the instruments governing the debt may restrict their ability to pay dividends or make other distributions to us.

In addition, Circular 75 requires PRC residents, including both legal persons and natural persons, to register with the competent local SAFE branch before establishing or controlling any company outside of China. If the PRC subsidiaries of an offshore parent company do not report the need for their PRC investors to register to the local SAFE authorities, they may be prohibited from distributing their profits and proceeds from any reduction in capital, share transfer or liquidation to their offshore parent company. Although we believe that our subsidiaries in China are in compliance with these regulations, should these regulations or the interpretation of them by PRC courts or regulatory agencies change, we may not be able to pay dividends outside of China.

Item 6. Selected Financial Data

Not required.

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

Safe Harbor Declaration

The comments made throughout this Annual 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.

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.

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.

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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 years ended December 31, 2015 and 2014.

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.

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.

On January 20, 2016, we entered a Share Purchase Agreement with a series of buyers to sell 85% of the equity shares of SmartHeat Deutschland GmbH ("SmartHeat Germany") for Euro 170,000 ($185,400). SmartHeat Germany was treated as a discontinued operations in the Company's consolidated results of operations for the years ended December 31, 2015 and 2014 under ASC 205-20-45-1E.

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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.

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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. On December 28, 2015, we entered into the Fourth Amendment to the Credit and Security Agreement dated July 27, 2012, (as first amended on December 21, 2012 and subsequently amended on August 23, 2013, and July 14, 2014, between the Company and Northtech). The Amendment provides that we will repay $1,600,000 of the outstanding principal and Northtech will extend the maturity date to July 31, 2016 in exchange for an extension fee of $100,000, 1,500,000 shares of common stock of SmartHeat, par value $.001 per share, which shall be restricted stock and a 10% Convertible Preferred Stock of its wholly owned subsidiary Heat HP, Inc. ("Heat HP") representing 20% of the voting power of Heat HP, having a conversion, redemption and liquidation value of $1,000,000 and a 10% cumulative dividend accruing and payable quarterly ($25,000 per quarter). In addition, the parties agreed to adjust the minimum conversion/exchange price in the Amendment from $.40 to $.20 per share and the maximum conversion/exchange price from $2.80 to $1.40 to reflect the current market conditions of the stock. The new maximum credit line was reduced to $2,500,000. As of December 31, 2015 and 2014, the outstanding credit line payable to Northtech was $2,455,335 and $2,749,335, respectively. As of December 31, 2015, Northtech owns 43.5% of the Company as a result of shares received from the Company for loan repayment and extension fee. In addition, Northtech became the 20% noncontrolling interest of Heat HP as a result of $1,000,000 loan repayment by issuing Series A Preferred Stock of Heat HP which can be convertible into 20% of the issued and outstanding Common Stock of Heat HP on fully diluted basis.

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.

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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, 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 year ended December 31, 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 year ended December 31, 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.

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 $1.41 million and $39.26 million at December 31, 2015 and 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 year ended December 31, 2015.

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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 years ended December 31, 2015 and 2014, revenue from after-sales services after the expiration of the warranty period was $120,197 and $215,867, 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)."

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. Based on its review, the Company believes that, as of December 31, 2015 and 2014, there was no significant impairment of its long-lived assets.

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.

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The 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.

In July 2015, the FASB issued ASU 2015-11, Inventory, which requires an entity to measure inventory within the scope at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The effective date for the standard is for fiscal years beginning after December 15, 2016. 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.

In September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments eliminate the requirement to retrospectively account for those adjustments. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments in this update are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The Company does not anticipate that this adoption will have a significant impact on its consolidated financial position, results of operations, or cash flows.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, "Balance Sheet Classification of Deferred Taxes". The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. This update is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company does not anticipate the adoption of this ASU will have a significant impact on its consolidated financial position, results of operations, or cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842). The guidance in ASU 2016-02 supersedes the lease recognition requirements in ASC Topic 840, Leases (FAS 13). ASU 2016-02requires an entity to recognize assets and liabilities arising from a lease for both financing and operating leases, along with additional qualitative and quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the effect this standard will have on its Consolidated Financial Statements.

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Other recent accounting pronouncements issued by the FASB, including its Emerging Issues Task Force, the American Institute of Certified Public Accountants, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

Results of Operations

Year ended December 31, 2015 Compared to the Year ended December 31, 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	$2,629,500		$5,219,210	
Cost of sales	5,931,602	226 %	4,817,390	92 %
Gross profit (loss)	(3,302,102)	(126)%	401,820	8 %
Operating expenses	3,829,905	146 %	4,213,051	81 %
Loss from operations	(7,132,007)	(271)%	(3,811,231)	(73)%
Non-operating income (expenses), net	(323,162)	(12)%	103,181	2 %
Income tax expense (benefit)	(22,043)	(1)%	48,717	1 %
Loss from continuing operations	(7,433,126)	(283)%	(3,756,767)	(72)%
Foreign currency translation gain on sold entities	11,915,632	453 %	-	- %
Loss from operations of discontinued entities, net of tax	(491,629)	(19)%	(9,129,047)	(175)%
Loss on disposal of discontinued entities, net of tax	(47,151,307)	(1793)%	-	- %
Less: loss attributable to noncontrolling interest from continuing operations	(21,828)	(1)%	(18,665)	(0.4)%
Less: loss attributable to noncontrolling interest from discontinued operations, net of tax	(5,900)	- %	(3,299,161)	(63)%
Net Loss to SmartHeat Inc.	$(43,132,702)	(1640)%	$(9,567,988)	(183)%

Sales. Net sales in the year ended December 31, 2015, were $2.63 million, while net sales in the year ended December 31, 2014, were $5.22 million, an overall decrease of $2.59 million or 50%. The 50% decrease in total revenue was due primarily to the decrease in sales of both PHEs and heat pumps in the year ended December 31, 2015, compared to the same period of 2014.

Cost of Sales. Cost of sales ("COS") was $5.93 million in the year ended December 31, 2015, compared to $4.82 million in the comparable period of 2014, an increase of $1.11 million or 23%. The increase in our COS is attributable to increased provision for inventory impairment for Sandeke. COS mainly consisted of the cost of materials, factory overhead and labor. Materials cost was 54% of total cost, while factory overhead cost was 38% and labor was 9% during the year ended December 31, 2015. Materials cost was 57% of total cost, while factory overhead cost was 38% and labor was 5% during the year ended December 31, 2014. Our materials cost as a percentage of total costs decreased to 54% from 57% as a result of decreased raw material price. Our products are custom-made; the raw material prices vary based on the place of origin, which was chosen at customers' choice. The COS as a percentage of sales was 226% in the year ended December 31, 2015 compared with 92% for the same period of 2014 due to increased provision for inventory impairment and decreased selling price resulting from increased competition.

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We performed an inventory impairment assessment as of December 31, 2015 and 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 allowance of $5,302,189 and $18,528,631 as of December 31, 2015 and 2014, respectively. We recorded inventory impairment provision of $3.29 million for the year ended December 31, 2015, compared to $7.15 million for the same period of 2014.

Gross Profit (Loss). Gross loss was $3.30 million in the year ended December 31, 2015, compared to gross profit of $0.40 million in the comparable period of 2014. Gross margin was (126)% and 8% for the years ended December 31, 2015 and 2014 respectively.

Operating Expenses. Operating expenses consisting of selling, general and administrative expenses totaled $3.83 million in the year ended December 31, 2015, compared to $4.21 million in the comparable period of 2014, a decrease of $0.38 million or 9%. Operating expenses as a percentage of sales were 146% in the year ended December 31, 2015, compared to 81% in the comparable period of 2014. The decrease in operating expenses was mainly due to decreased selling, general and administrative expense of $3.81 million for the year ended December 31, 2015 as a result of decreased sales, compared with $4.31 million selling, general and administrative expense for the year ended December 31, 2014. Although we had $4.71 million reversal of provision for bad debts for the year ended December 31, 2014 but we had provision for advance to suppliers of $4.61 million for the year ended December 31, 2014 while there was $0 for the year ended December 31, 2015.

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 year ended December 31, 2015 was $0.32 million compared to net non-operating income of $0.10 million for the comparable period of 2014, an increase of expenses of $0.43 million or 413%. The increase in non-operating expenses was due mainly to increased interest expense of $0.37 million and decreased net other income of $0.12 million for the year ended December 31, 2015, compared to interest expense of $0.21 million and net other income of $0.46 million (mainly from government subsidy) for the comparable period of 2014.

Loss from Discontinued Operations. We had loss from discontinued operations of $47.15 million including loss on sale of SmartHeat Germany of $0.49 million and loss on sale of 100% equity interest of Taiyu, Siping, Shenyang Energy, Ruicheng, and Xinrui of $47.15 million, with cumulative foreign currency translation gain of $11.92 million on sold entities for the year ended December 31, 2015, compared to loss from discontinued operations of $9.13 million for the comparable period of 2014.

On January 20, 2016, we entered a Share Purchase Agreement with a series of buyers to sell 85% of the equity shares of SmartHeat Deutschland GmbH (“SmartHeat Germany”) for Euro 170,000 ($185,400). SmartHeat Germany was treated as a discontinued operations in the Company’s consolidated results of operations for the years ended December 31, 2015 and 2014 under ASC 205-20-45-1E.

Net Loss. Our net loss for the year ended December 31, 2015 was $43.13 million compared to net loss of $9.57 million for the comparable period of 2014, an increase of $33.56 million or 351%. Net loss as a percentage of sales was 1640% in the year ended December 31, 2015, and net loss as a percentage of sales was 183% in the comparable period of 2014. This increase in net loss was mainly attributable to loss on sale of 100% equity interest of Taiyu, Siping, Shenyang Energy, Ruicheng, and Xinrui in the year ended December 31, 2015.

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Liquidity and Capital Resources

As of December 31, 2015, we had cash and equivalents of $1.74 million. Working capital was $2.02 million at December 31, 2015. The ratio of current assets to current liabilities was 1.40:1 at December 31, 2015.

The Company had revolving line of credit providing for borrowings of up to $2.50 million with maturity on July 31, 2016, to address the cash needs of the Company's US parent. The outstanding balance under the Credit Agreement as of December 31, 2015 was $2.46 million.

The following is a summary of cash provided by or used in each of the indicated types of activities during the years ended December 31, 2015 and 2014:

	2015	2014
Cash provided by (used in):		
Operating activities	$(3,361,546)	$(3,804,267)
Investing activities	$(9,613,581)	$3,965,887
Financing activities	$1,206,000	$68,663

Net cash flow used in operating activities was $3.36 million in the year ended December 31, 2015, compared to net cash flow used in operating activities of $3.80 million in the comparable period of 2014. The decrease in net cash outflow in operating activities was due mainly to decreased cash outflow for other receivable of $1.64 million in the year ended December 31, 2015, compared with $4.20 million in 2014, as well as less payment for inventory, despite we had decreased cash inflow from accounts receivable of $0.66 million in the year ended December 31, 2015, compared with $$4.85 million in 2014, resulting from 100% equity interest sale of certain subsidiaries in 2015.

Net cash flow used in investing activities was $9.61 million in the year ended December 31, 2015, compared to net cash provided by investing activities of $3.97 million in the comparable period of 2014. In the year ended December 31, 2015, we had $9.49 million cash disposed for sale of equity interest on certain subsidiaries, $0.17 million cash outflow for notes receivable, and $0.02 million cash outflow for purchase of fixed assets, but offset with $0.06 million cash inflow from changes in restricted cash; while in the same period of 2014, we had $0.48 million cash inflow from note receivable, $10.32 million cash inflow from government refund of land use right of HEAT Energy, $0.13 million cash inflow from assets disposal, and $1.38 million cash inflow from sale of equity interest on certain subsidiaries, offset with $0.87 million cash outflow for purchase of fixed assets, $7.42 million cash outflow from changes in restricted cash, and $0.06 million cash outflow from construction in progress.

Net cash provided by financing activities was $1.21 million in the year ended December 31, 2015, compared to $0.07 million cash provided by financing activities in the comparable period of 2014. The cash inflow in the year ended December 31, 2015 consisted primarily of proceeds from a credit line of $1.21 million. In the year ended December 31, 2014, we had proceeds from a credit line of $1.45 million and proceeds from short-term loans of $28.87 million, but offset with repayment on short-term loans of $30.26 million.

As of December 31, 2015, we had gross accounts receivable (including retention receivable) of $2,260,951, of which $152,743 was with aging within 30 days, $320,124 with aging between 31 and 90 days, $358,735 with aging between 91 and 180 days, $1,429,349 with aging between 181 and 360 days, and $0 with aging over 360 days. At December 31, 2015, net accounts receivable was $673,186, or gross accounts receivable (including retention receivable) of $2,260,951 less bad debt allowance of $1,413,516, and gross retention receivables of $174,249.

Historically our accounts receivable remained outstanding for a significant period of time based on the standard payment terms with our customers. The increase in amount of accounts receivable outstanding for more than 180 days was historically due mainly to payment delays from certain state-owned customers that experienced working capital difficulties because of the current deflationary fiscal policy of the PRC government. Bad debt allowance was reserved in accordance with the Company's accounting policy, though the Company continues to work to collect all funds due.

The terms of our contracts in our heat pump business require an advance payment upon the execution of a contract or purchase order and a final payment prior to shipping goods which should reduce our outstanding receivables due in the future. In addition, we provide replacement parts and maintenance on our products if they break down within prescribed periods.

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Dividend Distribution

We are a US holding company that conducts substantially all of our business through our wholly owned and other consolidated operating entities in China and Germany. We rely in part on dividends paid by our subsidiaries in China for our cash needs, including the funds necessary to pay dividends and other cash distributions to our shareholders, to service any debt we may incur and to pay our operating expenses. The payment of dividends by entities organized in China is subject to limitations. In particular, PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Our PRC subsidiaries also are required to set aside at least 10% of their after-tax profit based on PRC accounting standards each year to a statutory surplus reserve fund until the accumulative amount of such reserve reaches 50% of registered capital. These reserves are not distributable as cash dividends. In addition, our PRC subsidiaries, at their discretion, may allocate a portion of their after-tax profit to their staff welfare and bonus fund, which may not be distributed to equity owners except in the event of liquidation. Moreover, if any of our subsidiaries incur debt on its own behalf in the future, the instruments governing the debt may restrict such subsidiary's ability to pay dividends or make other distributions to us. Any limitation on the ability of one of our subsidiaries to distribute dividends and other distributions to us could materially and adversely limit our ability to make investments or acquisitions that could be beneficial to our businesses, pay dividends or otherwise fund and conduct our business.

Off-Balance Sheet Arrangements

We have not entered into any other financial guarantees or other commitments to guarantee the payment obligations of any third parties other than as described following under "Contractual Obligations." We have not entered into any derivative contracts that are indexed to our shares and classified as stockholders' equity or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

Contractual Obligations

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
Due August 11, 2015 with interest of 7.20%, guaranteed by Heat Pump and SanDeKe	3,268,508	Taiyu
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 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	

The banks sometimes require loan guarantee 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 46 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.

After giving effect to the Stock Sale on December 31, 2014, we are not obligated to repay any of the foregoing loans.

Contingencies

The Company’s former operations were conducted in the PRC and were 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.

Our current operations are conducted in Germany with the sales of our products taking place principally in China. Accordingly, we may still be exposed to certain political and economic risks in China as discussed above and currency fluctuations between the Euro and the RMB. However, our sales, purchase and expense transactions in Germany are denominated in Euros.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Not required.

Item 8. Financial Statements and Supplementary Data

Our financial statements, together with the report thereon, appear in a separate section of this Annual Report beginning on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our President and Acting Chief Accountant, our principal executive officer and acting principal financial officer, respectively, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of the end of the period covered by this report. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our President and Acting Chief Accountant, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our President and Acting Chief Accountant concluded that, as of December 31, 2015, our disclosure controls and procedures were not effective as of such date because of a material weakness identified in our internal control over financial reporting related to our internal level of U.S. GAAP expertise. We lack sufficient personnel with the appropriate level of knowledge, experience and training in U.S. GAAP for the preparation of financial statements in accordance with U.S. GAAP. None of our internal accounting staff, including our Acting Chief Accountant, that are primarily responsible for the preparation of our books and records and financial statements in compliance with U.S. GAAP holds a license such as Certified Public Accountant in the U.S., nor have any attended U.S. institutions or extended educational programs that would provide enough of the relevant education relating to U.S. GAAP.

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Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with US GAAP, and the receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Therefore, internal control over financial reporting determined to be effective provides only reasonable assurance regarding the reliability of financial reporting and the preparations of financial statements for external purposes in accordance with generally accepted accounting principles.

Our management carried out an evaluation of the effectiveness of our internal control over financial reporting based on the framework in “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon this evaluation, our management concluded that our internal control over financial reporting was not effective as of December 31, 2015, because of a material weakness related to our internal level of U.S. GAAP expertise. We lack sufficient personnel with the appropriate level of knowledge, experience and training in U.S. GAAP for the preparation of financial statements in accordance with U.S. GAAP. None of our internal accounting staff, including our Chief Financial Officer, that are primarily responsible for the preparation of our books and records and financial statements in compliance with U.S. GAAP holds a license such as Certified Public Accountant in the U.S., nor have any attended U.S. institutions or extended educational programs that would provide enough of the relevant education relating to U.S. GAAP.

In order to mitigate the foregoing material weakness, we engaged an outside accounting consultant to assist us in the preparation of our financial statements to ensure that these financial statements are prepared in conformity to U.S. GAAP. Our outside accounting consultant is a Certified Public Accountant in the U.S. and has significant experience in the preparation of financial statements in conformity with U.S. GAAP. Our Chief Financial Officer and internal accounting personnel consult with our outside accounting consultant on an ongoing basis with regards to our treatment and conversion of financials from PRC GAAP to U.S. GAAP. We believe that the engagement of this outside accounting consultant lessens the possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis, and we will continue to monitor the effectiveness of this action and make any changes that our management deems appropriate. We expect to continue to rely on this outside consulting arrangement to supplement our current internal accounting staff for the foreseeable future.

Our Board of Directors and management are evaluating remediation measures that we will undertake to address this material weakness and will continue this evaluation in order to implement a comprehensive remediation plan. We expect that this plan will include but not be limited to (a) appointing a principal accounting officer with extensive U.S. GAAP training and experience, (b) hiring accounting personnel with appropriate knowledge and experience in U.S. GAAP and (c) providing more training on U.S. GAAP to accounting and other relevant personnel responsible for the preparation of books, records and financial statements. In the interim, our Acting Chief Accountant has attended U.S. GAAP training courses conducted by our outside Sarbanes-Oxley consultant and intends to continue attending training courses in U.S. GAAP. Until such time as we hire qualified accounting staff and train our current accounting staff with the requisite U.S. GAAP experience, however, it is unlikely we will be able to remediate this material weakness in our internal control over financial reporting.

We believe that the foregoing steps will remediate the material weakness identified above, and we will continue to monitor the effectiveness of these steps and make any changes that our management deems appropriate.

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Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the fiscal year ended December 31, 2015, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The following table sets forth the names of our directors, executive officers and their ages, positions and biographical information as of the date of this report. Our executive officers are appointed by, and serve at the discretion of, our Board of Directors. Our directors hold office for one-year terms or until their successors have been elected and qualified. There are no family relationships between any of our directors, executive officers or other key personnel and any other of our directors, executive officers or key personnel. There are no arrangements or understandings between any of our directors or executive officers and any other persons pursuant to which such director or executive officer was selected in that capacity.

Name	Age	Position
Oliver Bialowons	47	President and Director
Yingkai Wang	43	Acting Chief Accountant
Kenneth Scipta	74	Director
Weiguo Wang	50	Director
Xin Li	42	Director
Qingtai Kong	69	Director

Oliver Bialowons, President and Director

Oliver Bialowons was appointed as a Director and as President of the Company on May 25, 2012, to fill the roles formerly held by Jun Wang. Mr. Bialowons brings more than 20 years of experience as a turnaround executive to the Board of Directors and management of the Company. He is chief executive officer of Bialowons & Associates GmbH. In 2009, Mr. Bialowons recently served as Chairman of Bowe Bell Howell Inc., a financially stressed U.S. based manufacturer of industrial logistics equipment with worldwide operations and distribution. Mr. Bialowons directed the restructuring of Boewe Bell Howell's business and eventual sale of the Bell Howell business to Bell and Howell, LLC, a portfolio company of Versa Capital Management, LLC. Mr. Bialowons continued to serve as Chairman of Bowe Bell Howell in the United States until March of 2012. Since March of 2012, Mr. Bialowons has also served as the Chief Executive Officer of IHR Platz in Germany. From 2008 to 2010, Mr. Bialowons was Chief Executive Officer of Boewe Systec AG and Wanderer Werke AG, and from 2007-2008 he was Chief Operating Officer of neckermann.de GmBH. Prior to 2007, Mr. Bialowons held various management positions at Mitsubishi Motors Corp. and DaimlerChrysler AG.

Yingkai Wang, Acting Chief Accountant

Yingkai Wang was appointed as our Acting Chief Accountant on June 7, 2013. Mr. Wang has served as our subsidiaries financial manager since 2007, and has been responsible for our internal financial reporting, establishing a budget and for analyzing our subsidiaries' overall financial position. Mr. Wang was previously the financial manager of Shengyang Zhong Zhijie Electric Equipment Co., Ltd. from 2004-2007, and Shenyang Materials Group from August 1996 – April 2004. Mr. Wang is acquainted with our subsidiaries' operations and was appointed to serve our Acting Chief Accountant by our Board of Directors as we continue to search for a new Chief Financial Officer.

Kenneth Scipta, Director

Kenneth Scipta was appointed to our Board of Directors and as Chairman of our Audit Committee on July 10, 2012. Mr. Scipta, a certified public accountant, has over 35 years of relevant accounting experience, and has served on several boards of directors. From 1993 to 1996, Mr. Scipta was the president and a board member of Mid-West

Springs Manufacturing Company, a NASDAQ traded company, where he was responsible for day to day operations, planning, administration and financial reporting. Upon Mr. Scipta's resignation he assumed the duties of president of the special products division, which included catalog sales, die springs and the development of international sales. Previously, from 1979-1993, Mr. Scipta served in various positions such as president, vice president of finance and vice president of sales and marketing for Mid-West's primary subsidiary. From 1998 to 2006, Mr. Scipta was the chief executive officer and a board member of First National Entertainment Company, a multi-million dollar company traded on NASDAQ.

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Weiguo Wang, Director

Mr. Wang was appointed to our Board of Directors on June 19, 2008, and serves currently as the Chairman of our Compensation Committee and member of our Audit Committee and Nominating and Corporate Governance Committee. Mr. Wang brings over eight years of relevant industry oversight and extensive engineering experience to the Board. Mr. Wang has served as a Director of the China Special Equipment Inspection and Research Agency since 2006. Prior positions include serving as a supervisor of the Lanzhou Heat Transfer & Save Energy Engineering Center in 2006, Assistant Secretary General of the China Standardization Committee on Boilers and Pressure Vessels in 2005 and Deputy General Manager of Boilers Standard (Beijing) Technology Services Center Co., Ltd. in 2004. From July 2001 to December 2003, Mr. Wang was a teacher at Tianjin University, China. Mr. Wang holds a bachelor's degree in Mechanics, a master's degree in Fluid Mechanics and a PhD in Fluid Mechanics, all from Beijing University. His skills include business analysis, industry analysis, and long-range planning, especially as applied to manufacturing and standards implementation.

Xin Li, Director

Mr. Li was appointed to our Board of Directors on July 29, 2009, and serves as the Chairman of our Nominating and Corporate Governance Committee and member of our Audit Committee and Compensation Committee. Mr. Li brings more than a decade of corporate governance and industrial operations management experience to the Board. He is a renowned management consultant in China and currently serves as the general manager of Beijing ShengGao Consulting Co., Ltd., a strategic advisory firm founded by him more than 10 years ago that focuses on providing strategic guidance and management training to global companies, including the Sangoal Metal Manufacturing Company in China. He also serves as an independent director and chairs the audit and various governance committees at several large Chinese domestic companies not listed in the United States. Mr. Li is a prolific writer in strategies and management issues. He has authored several books in the areas of management science and strategic planning. Mr. Li is proficient in Mandarin Chinese and English. He has an MBA and is a Research Fellow at the Management Science Center of Beijing University.

Qingtai Kong, Director

Mr. Kong was appointed to our Board of Directors on September 22, 2011, and serves as a member of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee. Mr. Kong is a senior engineer bringing over 20 years of management experience in the gas supply and heating industry in China to the Board, and he currently serves as commissioner of China's Industrial Gas Committee. From 1995 to 2001, Mr. Kong served as Deputy Director overseeing district heating projects for the Qinhuangdao District Bureau of Municipal & Rural Construction in Hebei Province. From 1991 to 1995, Mr. Kong served as general manager of the state-owned utility Gas Supply Corporation of Qinhuangdao in Hebei Province. Mr. Kong's career in the gas industry began in 1988 with his position as chief engineer of a gas network project in the city of Qinhuangdao.

Legal Proceedings

Oliver Bialowons, our President, was an executive officer of Bowe Bell & Howell Company, a U.S. based manufacturer of industrial logistics equipment with worldwide operations and distribution, which filed for bankruptcy in April of 2011. Bowe Bell & Howell Company acted as debtor in possession and no external receiver was appointed in the bankruptcy proceeding. The bankruptcy proceeding was subsequently dismissed in March of 2012.

Mr. Bialowons also served as chief executive officer of Wanderer-Werke AG from December 2008 to March 2010, and Boewe Systec AG from December 2008 to November 2010. Wanderer-Werke AG and Boewe Systec AG filed for insolvency in Germany in May of 2010.

Other than as disclosed above during the past ten years, none of our directors or executive officers has been:

- The subject of any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time;
- Convicted in a criminal proceeding or is subject to a pending criminal proceeding (excluding traffic violations and other minor offenses);

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- Subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in an type of business, securities or banking activities;

- Found by a court of competent jurisdiction (in a civil action), the SEC or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, that has not been reversed, suspended, or vacated;

- Subject of, or a party to, any order, judgment, decree or finding, not subsequently reversed, suspended or vacated, relating to an alleged violation of a federal or state securities or commodities law or regulation, respecting financial institutions or insurance companies, law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or

- Subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization, any registered entity or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

None of our directors, officers or affiliates, or any beneficial owner of 5% or more of our common stock, or any associate of such persons, is an adverse party in any material proceeding to, or has a material interest adverse to, us or any of our subsidiaries.

Audit Committee and Audit Committee Financial Expert

We have established a separately-designated standing audit committee in accordance with Section 3(a)(58)(A) of the Exchange Act. Our Audit Committee consists of Messrs. Scipta, Wang, Li and Kong, each of whom is an independent director. Mr. Scipta, Chairman of the Audit Committee, is an “audit committee financial expert” as defined under Item 407(d) of Regulation S-K. The purpose of the Audit Committee is to represent and assist our Board of Directors in its general oversight of our accounting and financial reporting processes, audits of the financial statements and internal control and audit functions. As more fully described in its charter, a copy of which is available on our website at www.smartheatinc.com, the functions of the Audit Committee include the following:

- Appointment of independent auditors, determination of their compensation and over sight of their work;

- Review the arrangement for and scope of the audit by independent auditors;

- Review the independence of the independent auditors;

- Consider the adequacy and effectiveness of the internal controls over financial reporting;

- Pre-approve audit and non-audit services;

- Establish procedures regarding complaints relating to accounting, internal accounting controls, or auditing matters;

- Review and approve any related party transactions;

- Discuss with management our major financial risk exposures and our risk assessment and risk management policies; and

-

Discuss with management and the independent auditors our draft quarterly interim and annual financial statements and key accounting and reporting matters.

Procedures for Shareholder Recommendations of Nominees to the Board of Directors

During 2015, there were no material changes to the procedures described in our Proxy Statement relating to the 2014 Annual Meeting of Shareholders by which shareholders may recommend nominees to our Board of Directors.

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Code of Ethics

Our Board of Directors has adopted a Code of Conduct, which applies to all of our directors, officers and employees that constitutes our “code of ethics” within the meaning of Section 406 of the Sarbanes-Oxley Act. The purpose of the Code of Conduct is to promote honest and ethical conduct. The Code of Conduct is posted on our website located at www.smartheatinc.com and is available in print, without charge, upon written request to SmartHeat Inc. at A-1, 10, Street 7, Shenyang Economic and Technological Development Zone, Shenyang, China 110141, Attn: Corporate Secretary. We intend to disclose any future amendments to our Code of Conduct, and any waivers of provisions of the Code of Conduct required to be disclosed under the rules of the SEC, on our website.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our executive officers and directors, and persons who own more than 10% of our common stock, to file reports regarding ownership of, and transactions in, our securities with the Commission and to provide us with copies of those filings. Northtech, Inc. did not file an amendment to Schedule 13D in 2015 with respect to the grant of 1,500,000 shares of stock in connection with the Fourth Amendment to the Credit Agreement. Based solely on our review of the copies received by us and on the written representations of certain reporting persons, we believe that all such Section 16(a) filing requirements were timely met during 2015.

Item 11. Executive Compensation

As a “smaller reporting company,” we have elected to follow the scaled disclosure requirements for smaller reporting companies with respect to the disclosures required by Item 402 of Regulation S-K. Under such scaled disclosure, we are not required to provide a Compensation Discussion and Analysis, Compensation Committee Report and certain other tabular and narrative disclosures relating to executive compensation.

Executive Compensation

The following table sets forth information concerning the compensation for the years ended December 31, 2014 and 2015, of each of our named executive officers.

Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(1)	Nonequity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Oliver Bialowons	2015	100,000	-	-	-	-	-	-	100,000
President	2014	100,000	-	-	-	-	-	-	100,000
Yingkai Wang	2015	21,242	-	-	-	-	-	-	21,242
Acting Chief Accountant	2014	21,242	-	-	-	-	-	-	21,242

(1) Amounts shown reflect aggregate grant date fair value of awards and do not reflect whether the recipient actually has realized a financial benefit from such grant, such as by selling the stock or exercising the options.

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The following table sets forth information concerning the outstanding equity awards held by each of our named executive officers at December 31, 2015.

Outstanding Equity Awards at Fiscal Year-End for 2015

	Option Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	(#) Unexercisable	Option Exercise Price ($)	Option Expiration Date
Oliver Bialowons	-	-	-	-
Yingkai Wang	-	-	-	-

Agreements with Personnel

On July 10, 2012, SmartHeat entered into an agreement with Mr. Oliver Bialowons, the Company's President, effective as of May 25, 2012 for a one-year term. His employment agreement is automatically renewed for another one year from May 25, 2013. Mr. Bialowons is compensated at $100,000 per year.

On March 27, 2014, Oliver Bialowons was granted by the Board of Directors 100,000 shares of the Company's common stock.

Each of the above agreements contains provisions prohibiting competition by such officers following their services to us.

We currently do not have any defined pension plan for our named executive officers. Pursuant to their executive agreements, we shall provide to such officers all the necessary insurances and social welfares, including but not limited to medical, work injury, maternity, retirement and unemployment insurance and housing fund, according to our policies and the relevant laws and regulations of local governmental authorities and the PRC.

We currently do not have nonqualified defined contribution or other plans that provides for the deferral of compensation for our named executive officers nor do we currently intend to establish any such plan.

Grants of Plan-Based Awards

On May 25, 2010, our shareholders approved the 2010 Equity Incentive Plan authorizing the issuance of up to 100,000 shares of our common stock. The Compensation Committee administers the Plan and may grant awards, including restricted shares, incentive stock options and nonqualified stock options, under the Plan to our officers, directors and employees pursuant to the guidelines set forth in the Plan.

On November 28, 2011, Jun Wang and Xudong Wang each received a grant of 32,500 restricted shares of our common stock under the 2010 Equity Incentive Plan in recognition of their service and contributions to us. The restricted shares were fully vested on the grant date and issued pursuant to exemptions from registration under the Securities Act.

On April 14, 2011, Xudong Wang received a grant of 5,000 restricted shares of our common stock under the 2010 Equity Incentive Plan with the intent of reflecting his expected future performance and to further align Mr. Wang's interests with those of our shareholders. The restricted shares were fully vested on the grant date and issued pursuant to exemptions from registration under the Securities Act.

On February 1, 2010, pursuant to his employment agreement, Xudong Wang received a grant of options to purchase 5,000 shares of our common stock at an exercise price per share of $118.50. The options have a life of 5 years and options to purchase 2,500 shares of our common stock vested on June 30, 2011, with the remaining options to purchase 2,500 shares of our common stock to vest on June 29, 2012, subject to Mr. Wang's continued employment.

Change-In-Control and Separation Agreements

Our agreement with Mr. Bialowons does not call for any for payments or benefits in connection with the resignation, severance, retirement or other termination.

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We do not have any other existing arrangements providing for payments or benefits in connection with the resignation, severance, retirement or other termination of any of our named executive officers, or a change in control of the company or a change in the named executive officer's responsibilities following a change in control.

Compensation of Directors

The following table sets forth information concerning the compensation of our directors for the year ended December 31, 2015.

Director Compensation Table for 2015

Name	Fees Earned or Paid in Cash ($)	Option Awards ($)	All Other Compensation ($)	Total ($)
Kenneth Scipta	25,000	-	2,500	27,500
Weiguo Wang	12,000	-	-	12,000
Xin Li	17,910	-	-	17,910
Qingtai Kong	3,750	-	-	3,750

Our independent directors receive cash compensation, paid in equal quarterly installments, for their service. In addition, at the discretion of the non-interested members of the Compensation Committee, independent directors are eligible to receive bonuses for service to our company outside the normal duties as a director and grants of options to purchase our common stock under the 2010 Equity Incentive Plan. Messrs. Li and Kong receive compensation of $17,910 and $3,750 per year, respectively, paid in equal quarterly installments. Mr. Scipta received $25,000 per year in 2015 and $30,000 per year in 2016, paid in equal quarterly installments. We do not compensate our non-independent directors for serving as our directors. All directors are eligible to receive reimbursement of expenses incurred with respect to attendance at board meetings and meetings of committees thereof, which is not included in the above table. We do not maintain a medical, dental or retirement benefits plan for the directors. On March 27, 2014, Ken Scipta was granted 50,000 shares of our common stock.

The directors may determine remuneration to be paid to the directors with interested members refraining from voting. The Compensation Committee will assist the directors in reviewing and approving the compensation structure for the directors.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following sets forth information as of March 31, 2016, regarding the number of shares of our common stock beneficially owned by (i) each person that we know beneficially owns more than 5% of our outstanding common stock, (ii) each of our named executive officers, (iii) each of our directors and (iv) all of our named executive officers and directors as a group.

The amounts and percentages of our common stock beneficially owned are reported on the basis of SEC rules governing the determination of beneficial ownership of securities. Under the SEC rules, a person is deemed to be a "beneficial owner" of a security if that person has or shares "voting power," which includes the power to vote or to direct the voting of such security, or "investment power," which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which that person has the right to acquire beneficial ownership within 60 days through the exercise of any stock option, warrant or other right. Under these rules, more than one person may be deemed a beneficial owner of the same securities and a person may be deemed to be a beneficial owner of securities as to which such person has no economic interest.

Unless otherwise indicated, each of the shareholders named in the table below, or his or her family members, has sole voting and investment power with respect to such shares of our common stock. Except as otherwise indicated, the address of each of the shareholders listed below is: c/o SmartHeat Inc., A-1, 10, Street 7, Shenyang Economic and Technological Development Zone, Shenyang, China 110141.

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As of March 31, 2016, there were 8,283,399 shares of our common stock issued and outstanding.

Name of beneficial owner	Number of shares		Percent of class	
5% Shareholders				
Northtech Holdings Inc. Mill Mall 5, Wickhams Cay 1 P.O. Box 3085 Road Town, Tortola British Virgin Islands	3,600,000	(1)	43.46	%
Beijing YSKN Machinery & Electronic Equipment Co., Ltd. Rm 1106, Huapu International Plaza No.19, Chaowai Street, Chaoyang District Beijing, China	680,800	(2)	8.2	%
Directors and Named Executive Officers				
Oliver Bialowons	200,000		2.1	%
Kenneth Scipta	50,000		0.06	%
All Directors and Named Executive Officers as a Group (2 Persons)	250,000		2.16	%

* Represents less than 1% of shares outstanding.

(1) Disclosed on the Schedule 13D for Northtech Holdings filed on March 7, 2013, as amended on August 29, 2013 and Form 4 filed on 7/28/2015 and records obtained from the transfer agent.

(2) Disclosed on Amendment No. 1 to the Schedule 13D for Beijing YSKN Machinery & Electronic Equipment Co., Ltd ("Beijing YSKN") filed on June 30, 2008, for beneficial ownership as of May 7, 2008. Beijing YSKN has sole power to vote and dispose of the shares owned by it. Jun Wang and Fang Li each hold 50% of the equitable and legal rights, title and interests in and to the share capital of Beijing YSKN and, as a result of such ownership, each of Messrs. Wang and Li has the shared power to vote and dispose of the shares held by Beijing YSKN.

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Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth information regarding all equity compensation plans, including individual compensation arrangements, under which our common stock is authorized for issuance as of December 31, 2016.

Equity Compensation Plan Information

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options		(b) Weighted-Average Exercise Price of Outstanding Options	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders				
2010 Equity Incentive Plan	-		-	0
Equity compensation plans not approved by security holders	1,000	(1)	$ 46.00	-
	5,000	(2)	118.50	-
Total	6,000		$ 106.40	0

(1) Consists of options granted to Arnold Staloff on July 17, 2008, to purchase 1,000 shares of our common stock at an exercise price per share of $46.00. The options vested in full over a three-year period and expired after five years.

(2) Consists of options granted to Xudong Wang on February 1, 2010, to purchase 5,000 shares of our common stock at an exercise price per share of $118.50. The options have a life of 5 years and options to purchase 2,500 shares of our common stock vested on June 30, 2011, with the remaining options to purchase 2,500 shares of our common stock to vest on June 29, 2012, subject to Mr. Wang’s continued employment.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Certain Relationships and Related Transactions

On July 27, 2012, we entered into a secured revolving credit facility under the terms of a Secured Credit Agreement with Northtech Holdings, Inc., an entity owned by certain members of the Company’s former management, Jun Wang, our former Chief Executive Officer, Xudong Wang, our former Vice President of Strategy and Development, and Wen Sha, our former Vice President of Marketing. Huajun Ai, our current 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 maturing 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 elected to repay $1,301,300 of the $1,384,455 outstanding under the Credit Agreement with 1,300,000 restricted shares of our common stock, 22.67% of our total issued and outstanding shares of Common Stock, as authorized by the Credit Agreement and approved by our shareholders.

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On December 30, 2014, the Company closed the transactions contemplated by the Equity Interest Purchase Agreement discussed above (See Sale of Equity Interests). The buyers consist of a group 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.

Except as disclosed above, there were no transactions with any related persons (as that term is defined in Item 404 in Regulation S-K) during 2015 or 2014, or any currently proposed transaction, in which we were or are to be a participant and the amount involved was in excess of $120,000 and in which any related person had a direct or indirect material interest.

Our written policy for related party transactions provides that we will enter into or ratify a transaction with a related party only when our Board of Directors, acting through the Audit Committee, determines that the transaction is in the best interests of the company and our shareholders. The policy requires the review and approval by our Audit Committee for any transaction in which (i) the aggregate amount involved will or may be expected to exceed $120,000 in any fiscal year, (ii) we are a participant and (iii) any related person has or will have a direct or indirect interest. Related persons include our executive officers, directors, director nominees, persons known to be the beneficial owner of more than 5% of our outstanding common stock or immediate family members of any of the foregoing persons. In determining whether to approve or ratify a transaction with a related party, the Audit Committee will take into account, among other relevant factors, whether the transaction is on terms no less favorable than terms generally available to an unaffiliated third party under the same or similar circumstances. If advance approval of a transaction is not feasible, the Audit Committee may approve and ratify the transaction in accordance with the policy. Any member of the Audit Committee who is a related party with respect to a transaction under review may not participate in the deliberations or vote on the approval of the transaction.

Director Independence

Our Board of Directors has determined that each of Kenneth Scipta, Weiguo Wang, Xin Li and Qingtai Kong is an independent director as defined by the listing standards of NASDAQ currently in effect and all applicable rules and regulations of the SEC. We have established the following standing committees of the Board of Directors: Audit, Compensation and Nominating and Corporate Governance. All members of the Audit, Compensation and Nominating and Corporate Governance Committees satisfy the independence standards applicable to members of each such committee. The Board of Directors made this affirmative determination regarding these directors' independence based on discussions with the directors and on its review of the directors' responses to a standard questionnaire regarding employment and compensation history; affiliations, family and other relationships; and transactions between us and the directors, if any. The Board of Directors considered relationships and transactions between each director, or any member of his immediate family, and our company, our subsidiaries and our affiliates. The purpose of the Board of Director's review with respect to each director was to determine whether any such relationships or transactions were inconsistent with a determination that the director is independent under NASDAQ rules.

Item 14. Principal Accounting Fees and Services

Our Audit Committee selected MJF & Associates as the independent registered certified public accounting firm to audit the books and accounts of our company and subsidiaries for the fiscal year ending December 31, 2016. MJF & Associates has served as our independent accountant since January 12, 2015. The following table presents the aggregate fees billed for professional services rendered by MJF & Associates for the years ended December 31, 2014 and 2015.

	2015	2014

Audit Fees		
MJF	132,000	$162,000
Audit-related fees		-
Tax fees	-	-
All other fees	-	-

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In the above table, “audit fees” are fees billed for services provided related to the audit of our annual financial statements, quarterly reviews of our interim financial statements and services normally provided by the independent accountant in connection with statutory and regulatory filings or engagements for those fiscal periods. “Audit-related fees” are fees not included in audit fees that are billed by the independent accountant for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements. “Tax fees” are fees billed by the independent accountant for professional services rendered for tax compliance, tax advice and tax planning. “All other fees” are fees billed by the independent accountant for products and services not included in the foregoing categories.

Audit Committee’s Pre-Approval Policy

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent accountants. These services may include audit services, audit-related services, tax services and other services. The Audit Committee has adopted a written policy for the pre-approval of services provided by the independent accountants, under which policy the Audit Committee generally pre-approves services for up to one year and any pre-approval is detailed as to the particular service or category of services and is subject to a specific budget. In addition, the Audit Committee may also pre-approve particular services on a case-by-case basis. For each proposed service, the independent accountant is required to provide detailed back-up documentation at the time of approval. The Audit Committee may delegate pre-approval authority to one or more of its members. Such a member must report any decisions to the Audit Committee at the next scheduled meeting.

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PART IV

Item 15. Exhibits, Financial Statement Schedules

The following documents are filed as part of or are included in this Annual Report:

1. Financial statements listed in the Index to Financial Statements, filed as part of this Annual Report beginning on page F-1; and
2. Exhibits listed in the Exhibit Index filed as part of this Annual Report.

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SMARTHEAT INC.

Consolidated Financial Statements
Years Ended December 31, 2015 and 2014

Index to Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
SmartHeat Inc

We have audited the accompanying consolidated balance sheet of SmartHeat Inc as of December 31, 2015 and December 31, 2014, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for the years then ended. SmartHeat Inc's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SmartHeat Inc as of December 31, 2015 and December 31, 2014, and the consolidated results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements were prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has incurred significant recurring losses from operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans are also discussed in Note 2 to the financial statements. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

MJF & Associates
Los Angeles, California
July 20, 2016

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2015	DECEMBER 31, 2014
ASSETS		
CURRENT ASSETS		
Cash and equivalents	$1,736,971	$13,682,624
Restricted cash	-	9,913,104
Accounts receivable, net	673,186	16,052,184
Retentions receivable, net	15,183	1,309,057
Advances to suppliers, net	6,070	2,417,949
Other receivables (net), prepayments and deposits	1,356,767	5,068,411
Inventories, net	3,053,189	49,349,195
Taxes receivable	7,986	325,252
Notes receivable - bank acceptances	162,327	2,271,131
Total current assets	7,011,679	100,388,907
NONCURRENT ASSETS		
Long term investment	-	29,540
Restricted cash	-	123,002
Property and equipment, net	916,245	1,995,520
Intangible assets, net	423,505	576,999
Construction in progress	-	84,533
Total noncurrent assets	1,339,750	2,809,594
TOTAL ASSETS	$8,351,429	$103,198,501
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$224,389	$7,384,756
Advances from customers	1,156,178	2,714,603
Taxes payable	32,507	196,246
Accrued liabilities and other payables	3,577,891	19,319,461
Notes payable - bank acceptances	-	1,401,530
Loans payable	-	25,111,702
Total current liabilities	4,990,965	56,128,298
CREDIT LINE PAYABLE	2,455,335	2,749,335
DEFERRED TAX LIABILITY	15,238	66,024
TOTAL LIABILITIES	7,461,538	58,943,657

COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock, $0.001 par value; 75,000,000 shares authorized, 8,283,399 and 6,783,399 shares issued and outstanding as of December 31, 2015 and 2014, respectively	8,283	6,783
Paid-in capital	98,435,254	87,500,456
Statutory reserve	780,682	5,389,057
Accumulated other comprehensive income	12,495,370	8,549,568
Accumulated deficit	(118,011,345)	(76,198,760)
Total Company stockholders' equity (deficit)	(6,291,756)	25,247,104
NONCONTROLLING INTEREST	7,181,647	19,007,740
TOTAL EQUITY	889,891	44,254,844
TOTAL LIABILITIES AND EQUITY	$8,351,429	$103,198,501

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	YEARS ENDED DECEMBER 31,	
	2015	2014
Net sales	$2,629,500	$5,219,210
Cost of sales	5,931,602	4,817,390
Gross income (loss)	(3,302,102)	401,820
Operating expenses		
Selling	1,541,933	1,815,133
General and administrative	2,269,603	2,493,529
Provision (reversal of provision) for bad debts	18,369	(4,709,372)
Provision for advance to suppliers	-	4,613,761
Total operating expenses	3,829,905	4,213,051
Loss from operations	(7,132,007)	(3,811,231)
Non-operating income (expenses)		
Interest income	6,036	9,408
Interest expense	(372,703)	(214,490)
Financial expense	(76,960)	(151,564)
Other income, net	120,465	459,827
Total non-operating income (expenses), net	(323,162)	103,181
Loss before income tax (benefit)	(7,455,169)	(3,708,050)
Income tax expense (benefit)	(22,043)	48,717
Loss from continuing operations	(7,433,126)	(3,756,767)
Cumulative foreign currency translation gain on disposed entities	11,915,632	-
Loss from operations of discontinued entities, net of tax	(491,629)	(9,129,047)
Loss on disposal of discontinued entities, net of tax	(47,151,307)	-
Net loss including noncontrolling interest	(43,160,430)	(12,885,814)
Less: loss attributable to noncontrolling interest from continuing operations	(21,828)	(18,665)
Less: loss attributable to noncontrolling interest from discontinued operations, net of tax	(5,900)	(3,299,161)

Net loss to SmartHeat Inc.	(43,132,702)	(9,567,988)
Other comprehensive item		
Foreign currency translation loss attributable to discontinued operations	(334,658)	(466,182)
Foreign currency translation gain (loss) attributable to SmartHeat Inc.	(565,207)	9,673
Foreign currency translation gain (loss) attributable to noncontrolling interest	6,986,976	(1,020)
Comprehensive loss attributable to SmartHeat Inc.	$(44,032,567)	$(10,024,497)
Comprehensive gain (loss) attributable to noncontrolling interest	$6,959,248	$(3,318,846)
Basic and diluted weighted average shares outstanding	6,799,837	6,564,084
Basic and diluted loss per share from continuing operations	$(1.09)	$(0.57)
Basic and diluted loss per share from discontinued operations	$(5.25)	$(0.89)
Basic and diluted net loss per share	$(6.34)	$(1.46)

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss including noncontrolling interest	$(43,160,430)	$(12,885,814)
Adjustments to reconcile loss including noncontrolling interest to net cash used in operating activities:		
Investment loss (gain)	-	(2,808)
Depreciation and amortization	441,431	816,240
Provision for bad debts	18,369	(6,950,613)
Provision for inventory impairment	3,293,870	7,145,929
Provision for advances to suppliers	-	5,756,939
Changes in warranty reserves	2,777	(44,518)
Gain on debt waiver	(8,790,015)	-
Gain on issuance of stock	-	(130,000)
Gain on disposal of fixed assets	-	(124,153)
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	(48,978)	48,717
(Increase) decrease in assets and liabilities:		
Accounts receivable	660,356	4,846,488
Retentions receivable	64,415	779,325
Advances to suppliers	8,327	656,818
Other receivables, prepayments and deposits	(1,644,882)	(4,199,351)
Inventories	473,025	(498,765)
Taxes receivable	19,913	653,891
Accounts payable	(261,194)	(439,247)
Advances from customers	(102,621)	(2,872,095)
Accrued liabilities and other payables	1,638,401	3,601,250
Net cash used in operating activities	(3,361,546)	(3,804,267)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in restricted cash	64,765	(7,421,563)
Cash received (disposed) from equity interest sale	(9,490,641)	1,383,666
Cash received from assets disposal	-	130,227
Acquisition of property and equipment	(18,467)	(867,851)
Government refund of land use right	-	10,322,150
Construction in progress	-	(57,020)
Notes receivable	(169,238)	476,278
Net cash provided by (used in) investing activities	(9,613,581)	3,965,887
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from bank loans	-	28,874,261

Repayment on bank loans	-	(30,255,598)
Change in credit line payable	1,206,000	1,450,000
Net cash provided by financing activities	1,206,000	68,663
EFFECT OF EXCHANGE RATE CHANGE ON CASH AND EQUIVALENTS	(176,526)	(150,058)
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(11,945,653)	80,225
CASH AND EQUIVALENTS, BEGINNING OF YEAR	13,682,624	13,602,399
CASH AND EQUIVALENTS, END OF YEAR	$1,736,971	$13,682,624
Supplemental cash flow data:		
Income tax paid	$-	$12,719
Interest paid	$-	$1,851,127
Supplemental disclosure of non-cash financing activities:		
Debts settled through shares issuance	$1,500,000	$-

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SMARTHEAT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
YEARS ENDED DECEMBER 31, 2015 AND 2014

	Common stock							
	Shares	Amount	Paid in capital	Statutory reserves	Accumulated other comprehensive income	Accumulated deficit	Total	Noncontrol interest
Balance at January 1, 2014	6,133,399	6,133	87,393,605	5,389,057	8,991,269	(66,630,772)	35,149,293	22,341,39
Shares issued to officers and directors	250,000	250	37,250	-	-	-	37,500	-
Shares issued for loan extension fee	400,000	400	69,600	-	-	-	70,000	-
Net loss for year	-	-	-	-	-	(9,567,988)	(9,567,988)	(3,317,82
Transfer to statutory reserves	-	-	-	-	-	-	-	-
Foreign currency translation loss	-	-	-	-	(441,701)	-	(441,701)	(15,828
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	19,007,74
Sale of 100% equity interest in certain subsidiaries	-	-	16,423,553	-	4,849,732	(3,288,258)	17,985,027	(18,789,40
Shares issued for loan extension fee	250,000	250	99,750	-	-	-	100,000	-
Shares issued for debt repayment	1,250,000	1,250	1,498,750	-	-	-	1,500,000	-

Net loss for year	-	-	-	-	-	(43,132,702)	(43,132,702)	(27,728
Reclassification of 20% of net equity of HEAT HP Inc. to noncontrolling interest resulting from Northtech loan repayment with 20% of the issued and outstanding common stock of HEAT HP Inc.	-	-	(7,087,255)	-	84,818	-	(7,002,437)	7,002,437
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 loss	-	-	-	-	(988,748)	-	(988,748)	(11,396
Balance at December 31, 2015	8,283,399	$8,283	$98,435,254	$780,682	$12,495,370	$(118,011,345)	$(6,291,756)	$7,181,647

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SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 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 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 Huajun Ai and Yingkai Wang, the Company's Corporate Secretary and Acting Chief Accountant, respectively. Huajun 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").

Principles of Consolidation

For the year ended December 31, 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 year ended December 31, 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 $7.43 million for the year ended December 31, 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 2014, which were 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.

Noncontrolling Interest

The Company follows Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") Topic 810, "Consolidation," which established new standards governing the accounting for and reporting of noncontrolling interests ("NCIs") in partially owned consolidated subsidiaries and the loss of control of subsidiaries. Certain provisions of this standard indicate, among other things, that NCIs, previously referred to as minority interests, be treated as a separate component of equity, not as a liability, as was previously the case, that increases and decreases in the parent's ownership interest that leave control intact be treated as equity transactions rather than as step acquisitions or dilution gains or losses and that losses of a partially owned consolidated subsidiary be allocated to the NCI even when such allocation might result in a deficit balance. This standard also required changes to certain presentation and disclosure requirements. Losses attributable to the NCI in a subsidiary may exceed the NCI's interests in the subsidiary's equity. The excess attributable to the NCI is attributed to those interests. The NCI shall continue to be attributed its share of losses even if that attribution results in a deficit NCI balance.

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The sale of 40% equity interest of Taiyu, SmartHeat Siping, SmartHeat Energy, Ruicheng and Xinrui (See Note 9) on December 30, 2013 resulted a 40% noncontrolling interest of the Company for 2014; and after the sale of remaining 60% of equity interest on December 31, 2014, the Company now owns 0% of Taiyu, SmartHeat Siping, SmartHeat Energy, Ruicheng and Xinrui.

On July 27, 2012, the Company entered into a secured, revolving credit facility under the terms of a Secured Credit Agreement with Northtech Holdings Inc., a British Virgin Islands business corporation ("Northtech") for the Company's working capital needs. On December 28, 2015, the Company entered into the Fourth Amendment to the Credit and Security Agreement dated July 27, 2012, as first amended on December 21, 2012 and subsequently amended on August 23, 2013, and July 14, 2014, between the Company and Northtech (see Note 14). Under the Fourth Amendment, SmartHeat paid loan repayment of $1,000,000, represented by such number of shares of Series A Preferred Stock of Heat HP convertible into 20% of the issued and outstanding Common Stock of Heat HP on fully diluted basis, with a conversion, redemption and liquidation value of $1,000,000, and a 10% cumulative dividend accruing and payable quarterly ($25,000 per quarter). Accordingly, Northtech became the 20% noncontrolling interest of Heat HP Inc.

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 December 31, 2015 and 2014, the Company maintained restricted cash deposits in several bank accounts for the purposes described below.

	2015	2014
	(In millions)	
Support of performance guarantee	$-	$0.41
Support of bank acceptance	-	0.70
Support of letter of credit	-	0.21
Financial product *	-	8.59
Total restricted cash - current	$-	$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 December 31, 2015 and 2014, based on the jurisdiction of deposit. The Company's US parent holds cash and equivalents in US bank accounts denominated in USD.

	China	Germany	Total

	United States			
December 31, 2015	$6,822	$1,575,771	$154,378	$1,736,971
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 $1.41 million and $39.26 million at December 31, 2015 and 2014, respectively.

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At December 31, 2015 and 2014, the Company had retentions receivable from customers for product quality assurance of $0.17 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 $0.16 million and $2.33 million at December 31, 2015 and 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.

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 December 31, 2015 and 2014, the Company had allowances for advances to suppliers of $2.29 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. Following the completion of the impairment analysis, the Company had inventory impairment allowance of $5.30 million and $18.53 million as of December 31, 2015 and 2014, respectively. The Company recorded inventory impairment provision of $3.29 million and $7.15 million for the years ended December 31, 2015 and 2014, respectively, which was included in the cost of sales.

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

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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. Based on its review, the Company believes that, as of December 31, 2015 and 2014, there was no significant impairment of its long-lived assets.

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 December 31, 2015, is as follows:

	2015	2014
Beginning balance	$472,558	$472,558
Provisions	-	338,589
Actual costs incurred	(67,275)	(338,589)
Reversal of warranty reserve due to disposal of subsidiaries	(405,283)	-
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 years ended December 31, 2015 and 2014, were $0 and $723,910, respectively.

Income Taxes

The Company utilizes FASB ASC Topic 740, "Income Taxes," which requires recognition of deferred tax assets and liabilities for expected future tax consequences of events included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

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When tax returns are filed, it is likely that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest associated with unrecognized tax benefits is classified as interest expense and penalties are classified as selling, general and administrative expense in the statements of operation. At December 31, 2015, the Company had not taken any significant uncertain tax position on its tax returns for 2014 or prior years, or in computing its tax provision for 2015.

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 year ended December 31, 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 years ended December 31, 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 years ended December 31, 2015 and 2014, revenue from after-sales services after the expiration of the warranty was $120,197 and $215,867, 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.

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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.

Concentration of Credit Risk

Cash includes cash on hand and demand deposits in accounts maintained within China. Balances at financial institutions within China are not covered by insurance. The Company has not experienced any losses in such accounts.

Certain other financial instruments, which subject the Company to concentration of credit risk, consist of accounts and other receivables. The Company does not require collateral or other security to support these receivables. The Company conducts periodic reviews of its customers' financial condition and customer payment practices to minimize collection risk on accounts receivable.

The operations of the Company are located primarily in China. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in China, as well as by the general state of the PRC economy.

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.

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 years ended December 31, 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 December 31, 2015 and 2014, no options and options to purchase 2,500 shares of common stock were outstanding and exercisable, respectively.

Fair Value of Financial Instruments

For certain of the Company's financial instruments, including cash and equivalents, restricted cash, accounts and other receivables, advances to suppliers, accounts payable, advances from customers, accrued liabilities and short-term debts, the carrying amounts approximate their FVs due to their short maturities. ASC Topic 820, "Fair Value Measurements and Disclosures," requires disclosure of the FV of financial instruments held by the Company. FASB ASC Topic 825, "Financial Instruments," defines FV, and establishes a three-level valuation hierarchy for disclosures of

FV measurement that enhances disclosure requirements for FV measures. The carrying amounts reported in the consolidated balance sheets for receivables and current liabilities each qualify as financial instruments and are a reasonable estimate of their fair values because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels of valuation hierarchy are defined as follows:

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

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

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

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The Company analyzes all financial instruments with features of both liabilities and equity under FASB ASC 480, "Distinguishing Liabilities from Equity," and ASC 815, "Derivatives and Hedging".

As of December 31, 2015 and 2014, the Company did not identify any assets and liabilities that are required to be presented on the balance sheet at FV.

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 December 31, 2015 and 2014, and the average exchange rates for the years ended December 31, 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 Years Ended		Balance Sheet Date Exchange Rate	
	12/31/15	12/31/14	12/31/15	12/31/14
RMB - USD	6.2284	6.1431	6.4936	6.1190
EUR - USD	0.9006	0.7525	0.9169	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.

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 year ended December 31, 2015, sales of PHEs was $368,973 and sales of heat pumps was $4,162,254.   Both businesses report to the same executives. Accordingly, there was no segment reporting for the year ended December 31, 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 ASC 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 FV 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.

In July 2015, the FASB issued ASU 2015-11, Inventory, which requires an entity to measure inventory within the scope at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The effective date for the standard is for fiscal years beginning after December 15, 2016. 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.

In September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments eliminate the requirement to retrospectively account for those adjustments. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments in this update are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The Company does not anticipate that this adoption will have a significant impact on its consolidated financial position, results of operations, or cash flows.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, "Balance Sheet Classification of Deferred Taxes". The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. This update is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company does not anticipate the adoption of this ASU will have a significant impact on its consolidated financial position, results of operations, or cash flows.

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In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842). The guidance in ASU 2016-02 supersedes the lease recognition requirements in ASC Topic 840, Leases (FAS 13). ASU 2016-02requires an entity to recognize assets and liabilities arising from a lease for both financing and operating leases, along with additional qualitative and quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the effect this standard will have on its Consolidated Financial Statements.

As of December 31, 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 December 31, 2015 and 2014, were as follows:

	2015	2014
Raw materials	$6,399,057	$47,748,997
Work in process	509,231	8,473,197
Finished goods	1,447,090	11,655,631
Total	8,355,378	67,877,825
Inventory allowance	(5,302,189)	(18,528,630)
Inventories, net	$3,053,189	$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 December 31, 2015 and 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 December 31, 2015 and 2014, respectively:

	2015	2014
Advances to unrelated third party companies	$599,605	$14,212,310
Deposit for public bids of sales contracts	-	168,235
Prepayment for freight, related insurance, advertisement and consulting expenses	100,000	287,998
Other deposits	-	60,185
Advances to employees	341,101	1,334,715
Other	359,664	676,157
Total	1,400,370	16,739,600
Less: bad debt allowance	(43,603)	(11,671,189)
Other receivables (net), prepayments and deposits	$1,356,767	$5,068,411

As of December 31, 2015, advances to unrelated third party companies were short-term unsecured advances due within a year. As of December 31, 2014, advances to unrelated 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 2016. 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.

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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 (net), prepayments and deposits are reimbursed or settled within 12 months.

6. PROPERTY AND EQUIPMENT, NET

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

	2015	2014
Buildings	$-	$4,967,230
Production equipment	1,583,894	9,134,092
Office equipment	197,828	1,139,249
Vehicles	230,237	932,657
Total	2,011,959	16,173,228
Less: accumulated depreciation	(1,095,714)	(5,661,537)
Less: impairment	-	(8,516,171)
Property and equipment, net	$916,245	$1,995,520

Depreciation for the years ended December 31, 2015 and 2014 was $230,551 and $371,172, 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 December 31, 2015 and 2014, respectively:

	Estimated Useful Life (In years)	2015	2014
Land use rights	50	$-	$4,134,587
Know-how technology	5–10	574,925	610,121
Software	5	152,455	460,899
Trademarks	7	280,310	297,471
Total		1,007,690	5,503,078
Less: accumulated amortization		(584,185)	(1,097,055)
Less: impairment of land use rights		-	(3,829,024)
Intangible assets, net		$423,505	$576,999

Amortization of intangible assets for the years ended December 31, 2015 and 2014 was $135,253 and $267,810, respectively. Annual amortization for the next five years from December 31, 2015 is expected to be $134,801, $121,569, $71,657, $63,139 and $32,339 thereafter.

8. CONSTRUCTION IN PROGRESS

As of December 31, 2014, SmartHeat Siping had construction in progress of $84,533 for expanding and upgrading its production line and production equipment.

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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.

10. TAXES RECEIVABLE

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

	2015	2014
Income	$-	$180,111
Value-added	5,706	122,816
Other	2,280	22,325
Taxes receivable	$7,986	$325,252

11. TAXES PAYABLE

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

	2015	2014
Income	$26,934	$-
Value-added	3,967	160,033
Other	1,606	36,213
Taxes payable	$32,507	$196,246

12. ACCRUED LIABILITIES AND OTHER PAYABLES

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

	2015	2014
Advances from third parties	$335,070	$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	1,415,585	2,805,560
Warranty reserve (See Note 2)	-	472,558
Accrued expenses	1,827,236	2,051,945
Total accrued liabilities and other payables	$3,577,891	$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 Taiyu to execute a sales order; however, the customer wanted to cancel the order after Taiyu commenced manufacturing and Taiyu refused to return the deposit claiming breach of contract by the customer.

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 was recorded as other payable.

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 December 31, 2015, accrued expenses mainly consisted of accrued property and land rental fee of $1.75 million, and accrued payroll of $69,123. 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 rental fee 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
Due August 11, 2015 with interest of 7.20%, guaranteed by Heat Pump and SanDeKe	3,268,508	Taiyu
	3,268,508	Taiyu

Due August 19, 2015 with interest of 7.20%, guaranteed by Heat Pump and SanDeKe		
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 (Related Party Transaction)

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.

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On December 28, 2015, the Company entered into the Fourth Amendment to the Credit and Security Agreement dated July 27, 2012, as first amended on December 21, 2012 and subsequently amended on August 23, 2013, and July 14, 2014, between the Company and Northtech. The Amendment provides that SmartHeat to pay 1) an extension fee of $100,000 for Northtech extending the maturity date to July 31, 2016 and a loan re-payment of $500,000 of outstanding principal (for a total payment of $600,000), represented by the delivery by the Company of 1,500,000 restricted shares of Common Stock at a price of $0.40 per share; 2) loan repayment of $1,000,000, represented by such number of shares of Series A Preferred Stock of Heat HP convertible into 20% of the issued and outstanding Common Stock of Heat HP on fully diluted basis, with a conversion, redemption and liquidation value of $1,000,000, and a 10% cumulative dividend accruing and payable quarterly ($25,000 per quarter). In addition, the parties agreed to adjust the minimum conversion/exchange price in the Amendment from $0.40 to $0.20 per share and the maximum conversion/exchange price from $2.80 to $1.40 to reflect the current market conditions of the stock. The new maximum credit line was reduced to $2,500,000.

As of December 31, 2015, Northtech owns 43.5% of the Company as a result of shares received from the Company for loan repayment and extension fee. In addition, Northtech became the 20% noncontrolling interest of Heat HP as a result of $1,000,000 loan repayment by issuing Series A Preferred Stock of Heat HP which can be convertible into 20% of the issued and outstanding Common Stock of Heat HP on fully diluted basis.

15. DEFERRED TAX ASSET (LIABILITY)

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

	2015	2014
Deferred tax asset - current (bad debt allowance for accounts receivable)	$559,197	$6,361,682
Deferred tax asset - current (bad debt allowance for retention receivable)	39,766	364,697
Deferred tax asset - current (inventory impairment provision)	1,325,547	3,446,251
Deferred tax asset – current (bad debt allowance for other receivables)	10,901	2,822,959
Deferred tax asset – current (allowance for advance to supplier)	571,639	589,761
Deferred tax asset – current (reserve for warranty)	-	42,643
Deferred tax asset – noncurrent (NOL of US parent company)	19,603,968	2,931,171
Deferred tax asset – noncurrent (NOL of PRC subsidiaries)	3,746,826	3,781,687
Deferred tax asset – noncurrent (impairment loss on long – lived assets)	-	3,054,588
Less: valuation allowance	(25,857,844)	(23,395,439)
Deferred tax assets, net	$-	$-
Deferred tax liability - noncurrent (depreciation of fixed assets)	$(15,238)	$(66,024)

The Company recorded a 100% valuation allowance for all deferred tax assets due to the uncertainty of its realization.

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 $57.66 million at December 31, 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.

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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 years ended December 31, 2015 and 2014:

	2015	2014
US statutory benefit rates	(34.0)%	(34.0)%
Tax rate difference	6.9 %	8.0 %
Effect of tax holiday	- %	5.0 %
Other	(2.3)%	- %
Valuation allowance	29.1 %	21.4 %
Tax expense (benefit) per financial statements	(0.3)%	0.4 %

The income tax expense (benefit) for the years ended December 31, 2015 and 2014, consisted of the following:

	2015	2014
Income tax expense - current	$26,935	$-
Income tax expense (benefit) - deferred	(48,978)	48,717
Total income tax expense (benefit), net	$(22,043)	$48,717

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.

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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.

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.

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.

On December 28, 2015, the Company entered into the Fourth Amendment to the Credit and Security Agreement with Northtech. The Amendment provides that SmartHeat to repay 1) an extension fee of $100,000 for Northtech extending the maturity date to July 31, 2016 and a loan re-payment of $500,000 of outstanding principal (for a total payment of $600,000), represented by the delivery by the Company of 1,500,000 restricted shares of Common Stock at a price of $0.40 per share; 2) loan repayment of $1,000,000, represented by such number of shares of Series A Preferred Stock of Heat HP convertible into 20% of the issued and outstanding Common Stock of Heat HP on fully diluted basis, with a conversion, redemption and liquidation value of $1,000,000,.and a 10% cumulative dividend accruing and payable quarterly ($25,000 per quarter). In addition, the parties agreed to adjust the minimum conversion/exchange price in the Amendment from $0.40 to $0.20 per share and the maximum conversion/exchange price from $2.80 to $1.40 to reflect the current market conditions of the stock. The new maximum credit line was reduced to $2,500,000.

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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.

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 years ended December 31, 2015 and 2014 was $275,105 and $465,800, 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 December 31, 2015, the Company is committed to contributing the remaining $40 million in registered capital to SmartHeat Investment by the end of 2017. 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. CONDENSED FINANCIAL INFORMATION OF US PARENT

SmartHeat Inc. is a holding company and owns no operating assets and has no significant operations independent of its subsidiaries. Set forth below are condensed financial statements of SmartHeat Inc. (US Parent) on a stand-alone, unconsolidated basis as of December 31, 2015 and 2014.

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CONDENSED BALANCE SHEETS

	2015	2014
ASSETS		
Cash and equivalents	$6,822	$68,103
Investment in subsidiaries	(3,599,049)	26,229,140
Other current assets	2,309,205	3,852,973
TOTAL ASSETS	$(1,283,022)	$30,150,216
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accrued liabilities and other payables	$5,008,736	$6,292,228
STOCKHOLDERS' EQUITY:		
Common stock	$8,283	$6,783
Additional paid-in capital	98,435,253	86,111,340
Statutory reserve	780,682	5,389,057
Other comprehensive income	12,495,369	8,549,568
Accumulated deficit	(118,011,344)	(76,198,760)
Total stockholders' equity	(6,291,758)	23,857,988
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$(1,283,022)	$30,150,216

CONDENSED STATEMENTS OF OPERATIONS

	2015	2014
Operating expenses		
General and administrative expenses	$1,294,202	$1,375,270
Loss from operations	(1,294,202)	(1,375,270)
Non-operating expenses	(35,684,004)	(233,056)
Equity loss in subsidiaries	(6,154,495)	(7,959,661)
Total non-operating loss	(41,838,499)	(8,192,717)
Loss before income tax	(43,132,701)	(9,567,987)
Income tax	-	-
Net loss	$(43,132,701)	$(9,567,987)

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CONDENSED STATEMENTS OF CASH FLOWS

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(43,132,701)	$(9,567,987)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	-	37,500
Gain on settlement of debt	(8,790,015)	-
Gain on issuance of stock	-	(130,000)
Amortization of loan origination and extension fee	75,627	148,566
Amortization of loan amendment fee paid by shares	-	28,685
Equity loss in subsidiaries	6,154,495	7,959,661
Loss on sale of equity interest	44,025,690	-
Increase in current liabilities	1,605,623	1,340,217
Net cash used in operating activities	(61,281)	(183,358)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in subsidiaries	-	-
CASH FLOWS FROM FINANCING ACTIVITIES:		
Credit line payable	-	-
Net cash provided by financing activities	-	-
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(61,281)	(183,358)
CASH AND EQUIVALENTS, BEGINNING OF YEAR	68,103	251,461
CASH AND EQUIVALENTS, END OF YEAR	$6,822	$68,103

22. 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.

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.

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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

23. SUBSEQUENT EVENT

On January 20, 2016, the Company entered and closed a Share Purchase Agreement with a series of buyers to sell 85% of the equity shares of SmartHeat Deutschland GmbH (“SmartHeat Germany”) for Euro 170,000 ($185,400). SmartHeat Germany was treated as a discontinued operations in the Company’s consolidated results of operations for the years ended December 31, 2015 and 2014 under ASC 205-20-45-1E, because A) Management having the authority to approve the action, commits to a plan to sell the entity to be sold. B) The entity to be sold is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such entities to be sold. C) An active program to locate a buyer or buyers and other actions required to complete the plan to sell the entity to be sold have been initiated. D) The sale of the entity to be sold is probable, and transfer of the entity to be sold is expected to qualify for recognition as a completed sale, within one year. E) The entity to be sold is being actively marketed for sale at a price that is reasonable in relation to its current fair value. F) Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SMARTHEAT INC.
(Registrant)

Date: July 20, 2016 By: /s/ Oliver Bialowons
Oliver Bialowons
President
(Principal Executive Officer)

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Oliver Bialowons his or her attorney-in-fact for him or her in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Oliver Bialowons Oliver Bialowons	President and Director (Principal Executive Officer)	July 20, 2016
/s/ Yingkai Wang Yingkai Wang	Acting Chief Accountant (Principal Financial and Accounting Officer)	July 20, 2016
/s/ Kenneth Scipta Kenneth Scipta	Director	July 20, 2016
/s/ Weiguo Wang Weiguo Wang	Director	July 20, 2016
/s/ Xin Li Xin Li	Director	July 20, 2016

/s/ Qingtai Kong Qingtai Kong	Director	July 20, 2016

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EXHIBIT INDEX

Exhibit No.	Description
2.1	Share Exchange Agreement and Plan of Reorganization by and among SmartHeat Inc., Shenyang Taiyu Electronic & Machinery Co., Ltd. and the Shareholders of Shenyang Taiyu Electronic & Machinery Co., Ltd., dated April 14, 2008 (Incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on April 18, 2008)
2.2	Articles of Exchange between Shenyang Taiyu Electronic & Machinery Co., Ltd. and SmartHeat Inc., dated April 14, 2008 (Incorporated herein by reference to Exhibit 2.2 to the Company's Current Report on Form 8-K filed on April 18, 2008)
2.3	Articles of Merger between Pacific Goldrim Resources, Inc. and SmartHeat Inc., dated April 14, 2008 (Incorporated herein by reference to Exhibit 2.3 to the Company's Current Report on Form 8-K filed on April 18, 2008)
3.1	Articles of Incorporation (Incorporated herein by reference to Exhibit 3.1 to the Company's Form SB-2 filed on December 22, 2006)
3.2	Amended and Restated By-Laws adopted April 15, 2008 (Incorporated herein by reference to Exhibit 3(ii) to the Company's Current Report on Form 8-K filed on October 16, 2008)
3(ii).2	Amended and Restated Bylaws of the Company, effective November 23, 2012
3.3	Certificate of Amendment to Articles of Incorporation, filed January 19, 2012, effective February 6, 2012 (Incorporated herein by reference to Exhibit 3.3 to the Company's Current Report on Form 8-K filed on January 20, 2012)
4.1	Specimen Stock Certificate (Incorporated herein by reference to Exhibit 4.1 of Amendment No. 2 to the Company's Registration Statement on Form S-1/A filed on February 4, 2009)
10.1#	English Translation of Employment Agreement between Shenyang Taiyu Machinery & Electronic Co., Ltd. and Jun Wang, dated January 1, 2008 (Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 18, 2008)
10.2#	English Translation of Employment Agreement between Shenyang Taiyu Machinery & Electronic Co., Ltd. and Zhijuan Guo, dated January 1, 2008 (Incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on April 18, 2008)
10.3	Certificate of Appointment by Sondex A/S of Shenyang Taiyu Machinery & Electronic Co., Ltd. as Authorized Dealer in China, dated March 2006 and letter naming Shenyang Taiyu Machinery & Electronic Co., Ltd. as Dealer of North China, dated May 5, 2006 (Incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on April 18, 2008)
10.4	Agreement of Conveyance, Transfer and Assignment of Assets and Assumption of Obligations between SmartHeat Inc. and PGR Holdings, Inc., dated April 14, 2008 (Incorporated herein by reference to Exhibit 10.11 to the Company's Current Report on Form 8-K filed on April 18, 2008)
10.5	Stock Purchase Agreement between Jason Schlombs and SmartHeat Inc., dated April 14, 2008 (Incorporated herein by reference to Exhibit 10.12 to the Company's Current Report on Form 8-K filed on April 18, 2008)
10.6	Form of Registration Rights Agreement (Incorporated herein by reference to Exhibit 10.14 to the Company's Current Report on Form 8-K filed on July 11, 2008)
10.7	English Translation of Share Exchange Agreement dated September 25, 2008, between SmartHeat Inc. and Asialink (Far East) Limited (Incorporated by reference to Exhibit 10.13 of Amendment No. 1 to the Company's Registration Statement on Form S-1/A filed on December 12, 2008)
10.8	English Translation of the Asset Acquisition Agreement, dated May 27, 2009, by and between Shenyang Taiyu Machinery & Electronic Co., Ltd. and Siping Beifang Heat Exchanger Manufacture Co., Ltd. (Incorporated herein by reference to Exhibit 10.14 to the Company's Current Report on Form 8-K filed on May 29, 2009)
10.9	

	English Translation of the Amended and Restated Asset Purchase Agreement, dated June 16, 2009, by and between Shenyang Taiyu Machinery & Electronic Co., Ltd. and Siping Beifang Heat Exchanger Manufacture Co., Ltd. (Incorporated herein by reference to Exhibit 10.15 to the Company's Current Report on Form 8-K/A filed on June 16, 2009)
10.10#	Employment Agreement, dated February 1, 2010, between SmartHeat Inc. and Xudong Wang (Incorporated herein by reference to Exhibit 10.18 to the Company's Current Report on Form 8-K filed on February 3, 2010)

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10.11	SmartHeat, Inc. 2010 Equity Incentive Plan (Incorporated herein by reference to the Company's Definitive Proxy Statement on Schedule 14A filed on April 16, 2010)
10.12	Credit and Security Agreement by and between SmartHeat Inc. and Northtech Holdings, dated July 27, 2012
10.13	December 2012 Amendment to the Credit and Security Agreement between SmartHeat Inc., and Northtech Holdings, Inc., dated December 21, 2012
10.14	August 2013 Amendment to the Credit and Security Agreement between SmartHeat Inc. and Northtech Holdings Inc., dated August 23, 2013 (Incorporated herein by reference to Exhibit 10.14 to the Company's Current Report on Form 8-K filed on August 6, 2010)
10.15	Assignment and Assumption Agreement between SmartHeat Inc., and Northtech Holdings Inc., dated August 23, 2013(Incorporated herein by reference to Exhibit 10.15 to the Company's Current Report on Form 8-K filed on August 6, 2010)
10.16	Assignment Agreement between SmartHeat Inc. and Heat HP, Inc., dated August 23, 2013(Incorporated herein by reference to Exhibit 10.16 to the Company's Current Report on Form 8-K filed on August 6, 2010)
10.17	Assignment Agreement between SmartHeat Inc. and Heat PHE, Inc., dated August 23, 2013(Incorporated herein by reference to Exhibit 10.17 to the Company's Current Report on Form 8-K filed on August 6, 2010)
10.18	Equity Interest Purchase Agreement by and between SmartHeat Inc. and the Buyers, dated October 10, 2013 (Incorporated herein by reference to Exhibit 10.18 to the Company's Current Report on Form 8-K filed on October 10, 2010)
	Amendment No. 4 to the Credit and Security Agreement between Northtech Holdings, Inc. and SmartHeat dated December 28, 2015
21.1†	Subsidiaries of the Registrant
24.1†	Power of Attorney (Included on the Signature Page of the Annual Report on Form 10-K filed on July 20, 2016)
31.1†	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2†	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1‡	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as signed by the Chief Executive Officer
32.2‡	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as signed by the Chief Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

#	Indicates management contract or compensatory plan, contract or arrangement.
†	Filed herewith.
‡	Furnished herewith.