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SALISBURY BANCORP INC  
Form PRER14A  
February 06, 2009

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

SCHEDULE 14A  
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the  
Securities and Exchange Act of 1934 (Amendment No. \_\_\_)

Filed by the Registrant  [X]  
Filed by a party other than the Registrant  [ ]

Check the appropriate box:

- [X] Preliminary Proxy Statement
- [ ] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- [ ] Definitive Proxy Statement
- [ ] Definitive Additional Materials
- [ ] Soliciting Material under ss. 240.14a-12

Salisbury Bancorp, Inc.

-----  
(Name of Registrant as Specified in Its Charter)

-----  
(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- [X] No fee required
- [ ] Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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(5) Total fee paid:

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[ ] Fee paid previously with preliminary materials.

[ ] Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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SALISBURY BANCORP, INC.  
5 BISSELL STREET  
P.O. BOX 1868  
LAKEVILLE, CONNECTICUT 06039

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS  
TO BE HELD ON March 10, 2009

To the Shareholders of Salisbury Bancorp, Inc.:

NOTICE IS HEREBY GIVEN that a Special Meeting of Shareholders of Salisbury Bancorp, Inc. (The "Company") will be held at 10:00 a.m., local time, on Tuesday, March 10, 2009 at The Interlaken Inn, 74 Interlaken Road, Route 112, Lakeville, Connecticut for the following purposes:

1. To approve an amendment to the Company's Certificate of Incorporation to authorize a class of 25,000 shares of preferred stock, par value \$0.01 per share; and
2. To transact such other business as may properly be brought before the Special Meeting or any adjournment(s) thereof.

Only those shareholders of record at the close of business on February 4, 2009 are entitled to notice of, and to vote at, this Special Meeting or any adjournment thereof.

In order that you may be represented at the Special Meeting, please complete, date, sign and mail promptly the enclosed proxy for which a postage-prepaid return envelope is provided.

BY ORDER OF THE BOARD OF DIRECTORS  
OF SALISBURY BANCORP, INC.

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/s/ John F. Foley

February 9, 2009  
Lakeville, Connecticut

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John F. Foley  
Secretary

SHAREHOLDERS ARE REQUESTED TO MARK, DATE, SIGN AND RETURN THE ENCLOSED PROXY AS SOON AS POSSIBLE REGARDLESS OF WHETHER THEY PLAN TO ATTEND THE MEETING. ANY PROXY GIVEN BY A SHAREHOLDER WHO EXECUTES AND RETURNS A PROXY AND WHO ATTENDS THE SPECIAL MEETING MAY WITHDRAW THE PROXY AT TIME BEFORE IT IS VOTED AND VOTE HIS OR HER SHARES IN PERSON. A PROXY MAY ALSO BE REVOKED BY GIVING NOTICE TO JOHN F. FOLEY, SECRETARY OF THE COMPANY, 5 BISSELL STREET, P.O. BOX 1868, LAKEVILLE, CT 06039, IN WRITING PRIOR TO THE TAKING OF A VOTE.

SALISBURY BANCORP, INC.  
5 BISSELL STREET  
LAKEVILLE, CT 06039  
860-435-9801

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PROXY STATEMENT  
FOR SPECIAL MEETING OF SHAREHOLDERS  
March 10, 2009  
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INTRODUCTION

The enclosed proxy card (the "Proxy") is solicited by the Board of Directors (the "Board of Directors") of Salisbury Bancorp, Inc. (the "Company"), for use at the Special Meeting of Shareholders (the "Special Meeting") to be held on Tuesday, March 10, 2009, at 10:00 a.m., at The Interlaken Inn, 74 Interlaken Road, Route 112, Lakeville, Connecticut 06039, and at any and all adjournments thereof. Any Proxy given may be revoked at any time before it is actually voted on any matter in accordance with the procedures set forth on the Notice of Special Meeting. This Proxy Statement and the enclosed form of Proxy are being mailed to shareholders (the "Shareholders") on or about February 9, 2009. The cost of preparing, assembling and mailing this Proxy Statement and the material enclosed herewith is being borne by the Company. In addition, proxies may be solicited by Directors, officers and employees of the Company and Salisbury Bank and Trust Company (the "Bank") personally by telephone or other means. The Company will reimburse banks, brokers, and other custodians, nominees, and fiduciaries for their reasonable and actual costs in sending the proxy materials to the beneficial owners of the Company's common stock (the "Common Stock"). The Company has engaged Morrow & Co., LLC to assist in the solicitation of proxies at a fee of \$7,500 plus expenses.

If your shares are in a brokerage or fiduciary account, your broker or bank will send you a voting instruction form instead of a Proxy. Please follow the instructions on such form to instruct your broker or bank how to vote your shares. If you wish to attend the Special Meeting and vote your shares in person, you must follow the instructions on the voting instructions form to obtain a legal proxy from your broker or bank.

OUTSTANDING STOCK AND VOTING RIGHTS

The Board of Directors has fixed the close of business on February 4, 2009 as the record date (the "Record Date") for the determination of Shareholders entitled to notice of and to vote at the Special Meeting. As of the Record Date, 1,685,861 shares of the Company's Common Stock (par value \$.10 per share) were outstanding and entitled to vote and held of record by approximately 1,500

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Shareholders of Record. Each share of Common Stock is entitled to one vote on all matters to be presented at the Special Meeting. Votes withheld, abstentions and broker non-votes are counted only for purposes of determining whether a quorum is present at the Special Meeting but will have the effect of a vote against Proposal 1.

A Proxy card is enclosed for your use. YOU ARE SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS TO COMPLETE, DATE, SIGN AND RETURN THE PROXY CARD IN THE ACCOMPANYING ENVELOPE, which is postage-prepaid if mailed in the United States.

If the enclosed form of Proxy is properly executed and received by the Company in time to be voted at the Special Meeting, the shares represented thereby will be voted in accordance with the instructions marked thereon. Executed, but unmarked proxies will be voted "FOR" Proposal 1 discussed in this Proxy Statement.

### CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This Proxy Statement may include forward-looking statements relating to such matters as:

- (a) assumptions concerning future economic and business conditions and their effect on the economy in general and on the markets in which the Company and Salisbury Bank and Trust Company (the "Bank") do business; and
- (b) expectations for revenues and earnings for the Company and Bank.

Such forward-looking statements are based on assumptions rather than historical or current facts and, therefore, are inherently uncertain and subject to risk. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Act of 1995.

The Company notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of the Company's and Bank's business include the following:

- (a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Bank operates;
- (b) changes in the legislative and regulatory environment that negatively impacts the Company and Bank through increased operating expenses;
- (c) increased competition from other financial and non-financial institutions;
- (d) the impact of technological advances; and
- (e) other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission.

Such developments could have an adverse impact on the Company's and the Bank's financial position and results of operations.

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## PROPOSAL 1

### APPROVAL OF AMENDMENT TO CERTIFICATE OF INCORPORATION

#### DESCRIPTION OF THE PROPOSAL

The Board of Directors has adopted an amendment to the Company's Certificate of Incorporation to authorize a class of 25,000 shares of preferred stock, par value \$0.01 per share (the "Preferred Stock"). The full text of the proposed amendment to the Company's Certificate of Incorporation is set forth in Exhibit A to this proxy statement. The Company's Certificate of Incorporation currently authorizes only the issuance of Common Stock. The proposed amendment will vest in the Board of Directors the authority to determine by resolution the terms of one or more series of Preferred Stock, including the preferences, rights and limitations of each series. Provisions in a company's certificate of incorporation authorizing preferred stock in this manner are often referred to as "blank check" provisions, as they give a board of directors the flexibility, at any time or from time to time, without further shareholder approval (except as may be required by applicable laws, regulatory authorities or the rules of any stock exchange on which a company's securities are then listed), to create one or more series of preferred stock and to determine by resolution the terms of each such series. The Board of Directors believes that authorization of the Preferred Stock in the manner proposed will provide the Company with greater flexibility in meeting future capital requirements by creating series of Preferred Stock customized to meet the needs of particular transactions and then prevailing market conditions. Series of Preferred Stock would also be available for issuance from time to time for any other proper corporate purposes, including in connection with the redemption of the Preferred Stock described below, strategic alliances, joint ventures, or acquisitions.

The Board of Directors does not have any plans calling for the issuance of shares of Preferred Stock at the present time, other than the possible issuance of Preferred Stock to the U.S. Department of the Treasury (the "Treasury") in connection with the Treasury's recently announced Troubled Asset Relief Program ("TARP") Capital Purchase Program described below.

#### TERMS OF THE CAPITAL PURCHASE PROGRAM

On October 14, 2008, the Treasury announced the TARP Capital Purchase Program. This program encourages U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy. Under the program, the Treasury will purchase senior preferred shares from banks, bank holding companies, and other financial institutions. The senior preferred shares will qualify as Tier 1 capital for regulatory purposes and will rank senior to common stock and at an equal level in the capital structure with any existing preferred shares other than preferred shares which by their terms rank junior to any other existing preferred shares. The senior preferred shares purchased by the Treasury will pay a cumulative dividend rate of 5 percent per annum for the first five years they are outstanding and thereafter at a rate of 9 percent per annum. The senior preferred shares will be non-voting, other than voting rights on matters that could adversely affect the shares. The shares will be callable at one hundred percent of their issue price plus any accrued and unpaid dividends after three years.

Prior to the end of three years, the senior preferred shares may be redeemed

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with the proceeds from a qualifying equity offering of any Tier 1 perpetual preferred or common stock.

If dividends on the senior preferred shares are not paid in full for six dividend periods, whether or not consecutive, the senior preferred shares will have the right to elect two directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

The Treasury will receive warrants to purchase a number of shares of common stock having an aggregate market price equal to 15% of the senior preferred shares on the date of investment, subject to reduction as set forth below. The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, will be the market price for the common stock on the date of the preliminary approval of the application (calculated on a 20-trading day trailing average), subject to customary anti-dilution adjustments. The warrants will have a term of ten years. The warrants will be immediately exercisable, in whole or in part. The warrants will not be subject to any contractual restrictions on transfer, provided that the Treasury may only transfer or exercise an aggregate of one-half of the warrants prior to the earlier of (i) the date on which the issuer has received aggregate gross proceeds of not less than 100% of the issue price of the senior preferred shares from one or more Qualified Equity Offerings (the sale by the issuer after the date of the sale of the senior preferred shares of Tier 1 qualifying perpetual preferred stock or common stock for cash) and (ii) December 31, 2009. In the event that the issuer receives aggregate gross proceeds of not less than 100% of the issue price of the senior preferred shares from one or more Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of common stock underlying the warrants then held by the Treasury will be reduced by a number of shares equal to the product of (i) the number of shares originally underlying the warrants (taking into account all adjustments) and (ii) 0.5.

An issuer participating in the Capital Purchase Program will be required to file a shelf registration statement with the Securities and Exchange Commission for the purpose of registering the senior preferred shares, the warrants and the common stock underlying the warrants as promptly as practicable after the date of the sale of the senior preferred shares and will take all action required to cause the shelf registration statement to be declared effective as soon as possible and maintain the effectiveness of the registration statement. The issuer will be required to apply for the listing on the national exchange on which the issuer's common stock is traded of the common stock underlying the warrants and will take such other steps as may be reasonably requested to facilitate the transfer of the warrants or the common stock.

The Treasury will agree not to exercise voting power with respect to any shares of common stock of the issuer issued to it upon exercise of the warrants.

The Treasury's consent also will be required for any increase in common stock dividends per share or certain repurchases of common stock until the third anniversary of the date of the investment unless prior to the third anniversary that the senior preferred shares are issued are redeemed in whole or the Treasury has transferred all of the senior preferred shares to third parties.

Banks and bank holding companies participating in the Capital Purchase Program also must modify or terminate all benefit plans, arrangements and agreements (including golden parachute agreements) to the extent necessary to be in compliance with the executive compensation and corporate governance requirements of Section 111 of the Emergency Economic Stabilization Act of 2008

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and any guidance or regulations issued by the Secretary of the Treasury for the period during which the Treasury holds equity issued under the Capital Purchase Program. These standards include: (i) ensuring that incentive compensation for specified senior executive officers does not encourage unnecessary and excessive risks that threaten the value of the Company; (ii) requiring a clawback of any bonus or incentive compensation paid to a specified senior executive officer based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (iii) prohibiting the Company from making any golden parachute payment to a specified senior executive officer based on applicable Internal Revenue Code provisions; and (iv) agreeing not to deduct for tax purposes executive compensation in excess of \$500,000 for each specified senior officer executive.

The Company has reviewed its executive compensation arrangements and does not anticipate that it will be necessary to modify any existing employee plans or contracts to comply with the applicable limits on executive compensation described above.

See Exhibit B for the Summary of Senior Preferred Terms and Summary of Warrant Terms as published by the Treasury.

### COMPANY PARTICIPATION IN THE CAPITAL PURCHASE PROGRAM

The Company received preliminary approval on January 7, 2009 from the Treasury to issue and sell up to 8,816 shares of the Preferred Stock and a warrant to purchase approximately 57,671 shares of Common Stock (the "Warrant") at an estimated exercise price of \$22.93 per share for aggregate consideration of \$8,816,000. Each share of Preferred Stock issued to the Treasury will have a liquidation preference of \$1,000. If the Company sells the maximum amount of Preferred Stock authorized under the Capital Purchase Program, the Company estimates that the ownership percentage of the current shareholders would be diluted by approximately 3.3% if the Warrant were fully exercised.

At September 30, 2008, the Company had capital ratios in excess of those required to be considered well-capitalized under banking regulations. The Board of Directors believes it is prudent for the Company to apply for capital available under the Capital Purchase Program because (i) the Company believes that the cost of capital under the Capital Purchase Program may be significantly lower than the cost of capital otherwise available to the Company at this time, and (ii) despite being well-capitalized, additional capital obtained under the capital Purchase Program would provide the Company additional flexibility to meet future capital needs that may arise.

5

The Board of Directors believes that the flexibility to issue shares of Preferred Stock other than under the Capital Purchase Program can enhance the Board of Director's arm's-length bargaining capability on behalf of the Company's shareholders in a takeover situation. However, under some circumstances, the ability to designate the rights of, and issue, Preferred Stock could be used by the Board of Directors to make a change in control of the Company more difficult.

The rights of the holders of the Company's Common Stock will be subject to, and may be adversely affected by, the rights of the holders of any Preferred Stock that may be issued in the future, including that issued under the Capital Purchase Program. To the extent that dividends will be payable on any issued shares of Preferred Stock, the result would be to reduce the amount otherwise available for payment of dividends on outstanding shares of the Company's Common Stock and there might be restrictions placed on the Company's ability to declare

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dividends on the Common Stock or to repurchase shares of Common Stock. The issuance of any Preferred Stock having voting rights would dilute the voting power of the holders of Common Stock. To the extent that any Preferred Stock is made convertible into shares of Common Stock, the effect, upon such conversion, would also be to dilute the voting power and ownership percentage of the holders of Common Stock. In addition, holders of Preferred Stock would normally receive superior rights in the event of any dissolution, liquidation, or winding up of the Company, thereby diminishing the rights of the holders of Common Stock to distribution of the Company's assets. Shares of Preferred Stock of any series would not entitle the holder to any pre-emptive right to purchase or subscribe for any shares of that or any other class.

The Company has not made a final determination as to whether it will participate in the Capital Purchase Program or if it does participate, the extent to which it will do so. Assuming that the amendment to the Certificate of Incorporation is approved by shareholders, the Board will make a final decision near to the time of the closing of the sale to the Treasury, which is currently scheduled to occur on March 13, 2009. Among the factors the Board will consider are the then-current economic conditions nationally, regionally and locally, the performance of the Bank at that time, especially of the loan portfolio, the capital and liquidity positions of the Company and the Bank at that time, and any restrictions on the use of the proceeds or corporate governance matters imposed by Congress, the Treasury or bank regulatory authorities between the date of this Proxy statement and the date that the Board makes the final determination or are anticipated to be imposed in the future. There can be no assurance that the Company will participate in the Capital Purchase Program, or if it does participate, the extent to which it will participate. If the amendment to the Certificate of Incorporation is approved by shareholders and the Company does not participate in the Capital Purchase Program, the Preferred Stock authorized will remain available for future issuance as described above.

6

### USE OF PROCEEDS

Subject to limitations on use of proceeds that may be specified by the Treasury, the Company intends to invest all of the proceeds from the issuance of the Preferred Stock to the Treasury as equity in the Bank, its wholly-owned banking subsidiary. The Company has identified the following priorities for the use of the funds by the Bank: (i) increase, where possible and prudent, additional consumer and commercial lending to stimulate economic activity in the Bank's local and regional markets; (ii) strengthen the Bank in the face of an uncertain and potentially prolonged economic downturn, which could have severe negative effects upon the national and regional economy and which could provoke credit or other than temporary impairment losses at the Bank at levels outside historical norms and (iii) possibly facilitate appropriate acquisitions of bank branches, or entire banks, whose capacity to flourish or even survive in the current economy has become suspect. Prior to such deployment, the funds may be used to reduce borrowings or augment investment securities.

### PRO FORMA EFFECT ON THE COMPANY'S FINANCIAL STATEMENTS

The following discusses the pro forma effect of participation in the Capital Purchase Program on the Company's financial statements. As indicated above, the Company was notified on January 7, 2009 that the Treasury had preliminarily approved the Company's application to participate in the Capital Purchase Program in the amount of \$8,816,000. This discussion assumes that the Company receives the entire \$8,816,000.

The pro forma effect of the receipt of \$8,816,000 under the Capital



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Purchase Program as of September 30, 2008 is as follows:

	As Reported September 30, 2008 (dollars in thousands)	Pro Forma as of September 30, 2008 (dollars in thousands)
Capital Purchase Program Investment	0	\$ 8,816
Total Tier 1 Capital	\$ 35,358	\$ 44,174
Total Tier 2 Capital	\$ 3,140	\$ 3,140
Total Capital (Tier 1 & 2)	\$ 38,498	\$ 47,314
Leverage Ratio	7.54%	9.25%
Tier 1 Ratio	12.08%	14.65%
Total Capital Ratio	13.15%	15.69%

(1) Minimum regulatory percentages for banks. All other numbers and percentages are calculated based on the Company's financial statements.

7

The following unaudited pro forma financial information of the Company for the fiscal year ended December 31, 2007 and the nine-month period ended September 30, 2008 show the effect of the receipt of \$8,816,000 from the Treasury pursuant to the Capital Purchase Program upon the issuance of Preferred Stock and the Warrant. The pro forma financial data is not necessarily indicative of the financial results that would have resulted had the proceeds of the Capital Purchase Program been received for the above periods and is not necessarily indicative of the results that the Company will achieve in the future. The Company can provide no assurance that the pro forma results will be achieved.

The Company has included the following unaudited pro forma financial information solely for the purpose of providing shareholders with information that may be useful for purposes of considering and evaluating the proposal to amend the Company's Certificate of Incorporation. The Company's future results are subject to prevailing economic, industry specific conditions, financial, business and other known and unknown risks, and uncertainties, certain of which are beyond the Company's control. These factors include, without limitation, those described in this Proxy Statement under "Cautionary Statement Concerning Forward-Looking Statements" and those described in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 and Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, which are specifically incorporated by reference in this Proxy Statement.

8

Pro Forma Effect - Balance Sheet

PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET  
SEPTEMBER 30, 2008  
(DOLLARS IN THOUSANDS)  
(UNAUDITED)

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	As of 09/30/08	Pro Forma Adjustments	Pro Forma
	-----	-----	-----
Balance Sheet Data:			
ASSETS			
Cash and due from banks	\$ 12,741	\$ 0	\$ 12,741
Securities available for sale, at fair value	144,482	0	144,482
Loans, net of allowance for loan losses (1)	293,740	8,816	302,556
Other Assets	34,687	0	34,687
	-----	-----	-----
TOTAL ASSETS	\$ 485,650	\$ 8,816	\$ 494,466
	=====	=====	=====
LIABILITIES			
Total deposits	\$ 344,608	0	\$ 344,608
Borrowings	98,861	0	98,861
Other Liabilities	3,461	0	3,461
	-----	-----	-----
TOTAL LIABILITIES	446,930	0	446,930
	-----	-----	-----
SHAREHOLDERS' EQUITY			
Preferred Stock (1) (2)	\$ 0	\$ 8,816	\$ 8,816
Capital Stock	169	0	169
Warrants (2) (4)	0	112	112
Discount on Preferred Stock (2) (3)	0	(112)	(112)
Surplus	13,158	0	13,158
Retained Earnings	34,037	0	34,037
Accumulated other comprehensive (loss) income	(8,644)	0	(8,644)
	-----	-----	-----
TOTAL SHAREHOLDERS' EQUITY	38,720	8,816	47,536
	-----	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 485,650	\$ 8,816	\$ 494,466
	=====	=====	=====

(1) Pro forma amounts are based on the investment by the Treasury pursuant to the Capital Purchase Program of the maximum amount of \$8,816,000 for which the Company has received preliminary approval. The Company expects ultimately to utilize the proceeds to (i) increase, where prudent, consumer and commercial lending; (ii) strengthen the Bank and (iii) when appropriate, facilitate the acquisition of bank branches or entire banks. Prior to such deployment, the proceeds may be used to reduce borrowings or augment investment securities. Expenses related to the issuance of the Preferred Stock and the Warrant to the Treasury are expected to be immaterial and have not been deducted from the sale proceeds.

(2) The proceeds from the sale of the securities to the Treasury would be allocated between the Preferred Stock and the Warrant based on their relative fair values on the issue date. The fair value of the Warrant would be determined using the Black-Scholes model, which includes assumptions regarding the price of the Common Stock, dividend yield and stock price volatility, as well as assumptions regarding the risk-free interest rate. The fair value of the Preferred Stock issued to the Treasury would be determined based on assumptions

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regarding the discount rate (market rate) on the Preferred Stock

(3) The discount on the Preferred Stock issued to the Treasury would be determined based on the value that is allocated to the Warrant upon issuance and would be accreted back to the value of the Preferred Stock over a five-year period upon issuance.

(4) Assuming participation in the Capital Purchase Program in the maximum amount of \$8,816,000 for which the Company has received preliminary approval, based on an exercise price of \$22.93 per share for the Warrant, the Company estimates that the Warrant would give the Treasury the right to purchase approximately 57,671 shares of Common Stock.

Pro Forma Effect - Income Statements

PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 PRO FORMA IMPACT OF MAXIMUM ESTIMATED PROCEEDS  
 \$8,816,000 PREFERRED AND WARRANTS FOR 57,671 SHARES  
 FOR THE YEAR ENDED DECEMBER 31, 2007  
 (IN THOUSANDS, EXCEPT PER SHARE DATA)

	Historical 12 Months Ended 12/31/07	Adjustments (unaudited)
	-----	-----
Net Interest Income	\$ 13,720	\$ 572 (1)
Loan Loss Provision	0	
	-----	-----
Net Interest Income after Provision	13,720	572
Noninterest Income	4,465	
Noninterest Expense	13,514	
	-----	-----
Income/(Loss) Before Taxes	4,671	572
Provision for Income Taxes	870	126 (2)
	-----	-----
Income before Preferred Dividends	3,801	446
Less: Preferred Dividends	0	441 (3)
	-----	-----
Income available to common shareholders	\$ 3,801	\$ 5
	=====	=====
Basic Earnings Per Share	\$ 2.26	\$ 0
	=====	=====
Diluted Earnings Per Share	\$ 2.26	\$ 0
	=====	=====
Weighted Average Shares Outstanding:		
Basic	1,684,699	0
Diluted	1,684,699	19,484 (4)

(1) Assumes maximum Capital Purchase Program proceeds of \$8,816,000 are used to increase loans at an assumed average annualized yield of approximately 6.49%. The actual impact to net interest income could be different as the Company expects ultimately to utilize a portion of the proceeds to (i) increase, where prudent, consumer and commercial lending; (ii) strengthen the Bank and (iii) when appropriate facilitate the acquisition of bank branches or entire banks. Prior to such deployment, the proceeds may be used to reduce borrowings or augment investment securities. Expenses related to the issuance of the Preferred

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Stock and the Warrant to the Treasury are expected to be immaterial and have not been deducted from the sale proceeds.

10

(2) Additional income tax expense is attributable to additional net interest income as described in Note (1).

(3) Consists of dividends on the Preferred Stock at a 5% annual rate as well as accretion on discount on the Preferred Stock upon issuance. The discount is determined based on the value that is allocated to the Warrant upon issuance. The discount is accreted back to par value over a five-year term, which is the expected life of the Preferred Stock upon issuance. The estimated accretion is based on a number of assumptions, which are subject to change. These assumptions include the discount (market rate at issuance) rate on the Preferred Stock and assumptions underlying the value of the Warrant. The estimated proceeds are allocated based on the relative fair value of the Warrant as compared to the fair value of the Preferred Stock. The fair value of the Warrant is determined under a Black-Scholes model. The model includes assumptions regarding the Common Stock price, dividend yield, stock price volatility, as well as assumptions regarding the risk-free interest rate. The lower the value of the Warrant, the lower is the negative impact on net income and earnings per share available to common shareholders. The fair value of the Preferred Stock is determined based on assumptions regarding the discount rate (market rate) on the Preferred Stock. The lower the discount rate, the lower is the negative impact on net income and earnings per share available to common shareholders.

(4) Assuming participation in the Capital Purchase Program in the maximum amount of \$8,816,000 for which the Company has received preliminary approval, based on an exercise price of \$22.93 per share for the Warrant, the Company estimates that the Warrant would give the Treasury the right to purchase approximately 57,671 shares of Common Stock. The pro forma adjustment shows the increase in diluted shares outstanding assuming that the Warrants had been issued on January 1, 2007 at the strike price of \$22.93 and remained outstanding for the entire period presented. The treasury stock method was utilized to determine dilution of the Warrant for the period presented.

PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 PRO FORMA IMPACT OF MAXIMUM ESTIMATED PROCEEDS  
 \$8,816,000 PREFERRED AND WARRANTS FOR 57,671 SHARES  
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008  
 (IN THOUSANDS, EXCEPT PER SHARE DATA)  
 (UNAUDITED)

	Historical 9 Months Ended 09/30/08	Adjustments
	-----	-----
Net Interest Income	\$ 11,666	\$ 411 (1)
Loan Loss Provision	690	
	-----	-----
Net Interest Income after Provision	10,976	411
Noninterest Income		
	1,241	
Noninterest Expense	11,183	
	-----	-----
Income/(Loss) Before Taxes	1,034	411

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Provision for Income Taxes	882	90 (2)
	-----	-----
Income before Preferred Dividends	152	321
Less: Preferred Dividends	0	331 (3)
	-----	-----
Income available to common shareholders	\$ 152	\$ (10)
	=====	=====
Basic Earnings Per Share	\$ 0.09	\$ 0
	=====	=====
Diluted Earnings Per Share	\$ 0.09	\$ 0
	=====	=====
Weighted Average Shares Outstanding:		
Basic	1,685,444	
Diluted	1,685,444	14,708 (4)

11

(1) Assumes maximum Capital Purchase Program proceeds of \$8,816,000 are used to increase loans at an assumed average annualized yield of approximately 6.21%. The actual impact to net interest income could be different as the Company expects ultimately to utilize a portion of the proceeds to (i) increase, where prudent, consumer and commercial lending; (ii) strengthen the Bank and (iii) when appropriate facilitate the acquisition of bank branches or entire banks. Prior to such deployment, the proceeds may be used to reduce borrowings or augment investment securities. Expenses related to the issuance of the Preferred Stock and the Warrant to the Treasury are expected to be immaterial and have not been deducted from the sale proceeds.

(2) Additional income tax expense is attributable to additional net interest income as described in Note (1).

(3) Consists of dividends on the Preferred Stock at a 5% annual rate as well as accretion on discount on the Preferred Stock upon issuance. The discount is determined based on the value that is allocated to the Warrant upon issuance. The discount is accreted back to par value over a five-year term, which is the expected life of the Preferred Stock upon issuance. The estimated accretion is based on a number of assumptions, which are subject to change. These assumptions include the discount (market rate at issuance) rate on the Preferred Stock and assumptions underlying the value of the Warrant. The estimated proceeds are allocated based on the relative fair value of the Warrant as compared to the fair value of the Preferred Stock. The fair value of the Warrant is determined under a Black-Scholes model. The model includes assumptions regarding the Common Stock price, dividend yield, stock price volatility, as well as assumptions regarding the risk-free interest rate. The lower the value of the Warrant, the lower is the negative impact on net income and earnings per share available to common shareholders. The fair value of the Preferred Stock is determined based on assumptions regarding the discount rate (market rate) on the Preferred Stock. The lower the discount rate, the lower is the negative impact on net income and earnings per share available to common shareholders.

(4) Assuming participation in the Capital Purchase Program in the maximum amount of \$8,816,000 for which the Company has received preliminary approval, based on an exercise price of \$22.93 per share for the Warrant, the Company estimates that the Warrant would give the Treasury the right to purchase approximately 57,671 shares of Common Stock. The pro forma adjustment shows the increase in diluted shares outstanding assuming that the Warrants had been issued on January 1, 2008 at the strike price of \$22.93 and remained outstanding for the entire period presented. The treasury stock method was utilized to determine dilution of the Warrant for the period presented.

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### APPROVAL REQUIREMENT AND BOARD OF DIRECTORS RECOMMENDATION

Approval of the proposed amendment to the Company's Certificate of Incorporation requires the approval of at least a majority of the votes entitled to be cast at the meeting.

THE BOARD UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE PROPOSAL TO AMEND THE COMPANY'S CERTIFICATE OF INCORPORATION.

12

### OTHER BUSINESS

The Company is not aware of any business to be acted upon at the Special Meeting other than that which is discussed in this Proxy Statement. In the event that any other business requiring a vote of the Shareholders is properly presented at the Special Meeting, the holders of the Proxies will vote your shares in accordance with their best judgment and the recommendations of a majority of the Board of Directors.

You are encouraged to exercise your right to vote by marking the appropriate boxes and dating and signing the enclosed Proxy card. The Proxy card may be returned in the enclosed envelope, postage-prepaid if mailed in the United States. In the event that you are later able to attend the Special Meeting, you may revoke your Proxy and vote your shares in person. A prompt response will be helpful and your cooperation is appreciated.

### SECURITY OWNERSHIP OF MANAGEMENT AND SHAREHOLDERS

The following table sets forth certain information as of December 31, 2008 regarding the number of shares of Common Stock beneficially owned by each Director and Executive Officer of the Company and by all Directors and Executive Officers of the Company as a group. Management is not aware of any person (including any "group" as defined in Rule 13(d)(3) of the Securities and Exchange Commission (the "SEC")) who owns beneficially more than 5% of the Common Stock as of December 31, 2008.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class (2)
Louis E. Allyn, II	1,481	.09%
John R. H. Blum	16,365 (3)	.97%
Louise F. Brown	2,928	.17%
Richard J. Cantele, Jr.	3,006 (4)	.18%
Robert S. Drucker	8,468 (5)	.50%
John F. Foley	7,443 (6)	.44%
Nancy F. Humphreys	1,840 (7)	.11%
Holly J. Nelson	1,888 (8)	.11%
John F. Perotti	11,454 (9)	.68%
Michael A. Varet	66,486 (10)	3.94%
<hr/>		
(All Directors and Executive Officers of the Company as a group of ten (10) persons)	121,359	7.20%

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(1) The shareholdings also include, in certain cases, shares owned by or in trust for a director's spouse and/or children or grandchildren, and in which all beneficial interest has been disclaimed by the Director or has the right to acquire such security within sixty (60) days of December 31, 2008.

13

- (2) Percentages are based upon the 1,685,861 shares of the Company's Common Stock outstanding and entitled to vote on December 31, 2008. The definition of beneficial owner includes any person who, directly or indirectly, through any contract, agreement or understanding, relationship or otherwise, has or shares voting power or investment power with respect to such security.
- (3) Includes 2,100 shares owned by John R. H. Blum's spouse.
- (4) Includes 1,320 shares owned jointly by Richard J. Cantele, Jr. and his spouse and 6 shares owned by Richard J. Cantele, Jr. as custodian for his daughter.
- (5) Includes 1,500 shares owned by Robert S. Drucker's spouse.
- (6) Includes 3,322 shares owned jointly by John F. Foley and his spouse, 1,543 owned by his spouse and 100 shares owned by John F. Foley as custodian for his children.
- (7) Includes 1,000 shares owned jointly by Nancy F. Humphreys and her spouse.
- (8) Includes 6 shares owned by Holly J. Nelson as guardian for a minor child.
- (9) Includes 9,514 shares owned jointly by John F. Perotti and his spouse, 1,100 shares owned by his spouse and 564 shares owned by his son, of which shares owned by his spouse and son, John F. Perotti has disclaimed beneficial ownership.
- (10) Includes 18,540 shares which are owned by his spouse and 18,546 shares which are owned by his children, of which shares Michael A. Varet has disclaimed beneficial ownership.

IMPORTANT NOTICE REGARDING THE AVAILABILTY OF PROXY MATERIALS FOR THE SPECIAL SHAREHOLDER MEETING TO BE HELD ON APRIL 10, 2009

THIS NOTICE AND PROXY STATEMENT ARE AVAILABLE AT [WWW.CFPProxy.COM/4607](http://WWW.CFPProxy.COM/4607).

Directions to the Interlaken Inn, 74 Interlaken Road, Route 112, Lakeville, Connecticut, may be obtained by writing to John F. Foley, Secretary, Salisbury Bancorp, Inc. 5 Bissell Street, PO Box 1868, Lakeville, CT 06039-1868, by calling 1-860-435-9801 or toll-free at 1-800-222-9801.

14

DEADLINE FOR SUBMISSION OF SHAREHOLDER PROPOSALS

Any proposal that a Company shareholder wishes to have included in the Company's Proxy Statement and form of Proxy relating to the Company's 2009 Annual Meeting of Shareholders under Rule 14a-8 of the SEC must have been

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received by the Company's Secretary by December 8, 2008.

In addition, under the Company's Bylaws, shareholders who wish to nominate a director or bring other business before an annual meeting must comply with the following:

- o You must be a shareholder of record and must have given notice in writing to the Secretary of the Company (a) not less than twenty (20) days nor more than one hundred thirty (130) days prior to the meeting with respect to matters other than the nomination of directors and (b) not less than thirty (30) days nor more than fifty (50) days prior to the meeting with respect to the nomination of directors.
- o Your notice must contain specific information required in the Company's Bylaws.

Nominations and proposals should be addressed to John F. Foley, Secretary, Salisbury Bancorp, Inc., 5 Bissell Street, PO Box 1868, Lakeville, CT 06039-1868.

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We do not anticipate that representatives from Shatswell, MacLeod & Company, P.C. will be present and available to respond to questions or make a statement at the Special Meeting.

15

### INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC's rules allow the Company to "incorporate by reference" into this Proxy Statement certain information the Company files with the SEC. Any information incorporated by reference into this Proxy Statement is considered to be part of this Proxy Statement. Any reports filed by the Company with the SEC after the date of this Proxy Statement will automatically update and, where applicable, supersede any information contained in this Proxy Statement or incorporated by reference in this Proxy Statement.

The Company incorporates by reference the following financial statements and other portions of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 as filed with the SEC on March 28, 2008 (the "Form 10-K") and the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 as filed with the SEC on November 13, 2008 (the "Form 10-Q"):

- o The audited consolidated financial statements and notes thereto and supplementary data as of and for the fiscal year ended December 31, 2007 appearing in Part II, Item 8 of the Form 10-K;
- o The unaudited condensed consolidated financial statements and notes thereto as of and for the three and nine months ended September 30, 2008 appearing in Part I, Item 1 of the Form 10-Q;
- o Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Part II, Item 7 of the Form 10-K and Part I, Item 2 of the Form 10-Q; and
- o Changes in and Disagreements with Accountants appearing in Part II, Item 9 of the Form 10-K.



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The Company will provide without charge to each person, including any beneficial owner, to whom this Proxy Statement is delivered, upon his or her written or oral request, by first class mail or other equally prompt means within one business day of receipt of such request, a copy of any or all documents referred to above that have been or may be incorporated by reference into this Proxy Statement, excluding exhibits to those documents unless they are specifically incorporated by reference into those documents. Copies of these filings may be requested, at no cost, by contacting John F. Foley, Secretary, Salisbury Bancorp, Inc., at 5 Bissell Street, PO Box 1868, Lakeville, CT 06039-1868 or by telephone at 1-860-435-9801 or toll-free at 1-800-222-9801.

By order of the Board of Directors

/s/ John F. Foley

-----  
John F. Foley  
Secretary

Lakeville, Connecticut  
February 9, 2009

16

Exhibit A

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PROPOSED AMENDMENT TO  
CERTIFICATE OF INCORPORATION  
OF  
SALISBURY BANCORP, INC.

Article THIRD shall be amended and restated in its entirety as follows:

THIRD: Capital Stock. The amount of the capital stock of the Corporation hereby authorized is three million (3,000,000) shares of Common Stock, par value \$0.10 per share and twenty-five thousand (25,000) shares of Preferred Stock, par value \$0.01 per share.

A. Common Stock.

Each holder of shares of Common Stock shall be entitled to one vote for each share held by such holder. There shall be no cumulative voting rights in the election of directors. Each share of Common Stock shall have the same relative rights as and be identical in all respects with all other shares of Common Stock. The voting, dividend and liquidation rights of the Common stock are subject to and qualified by the rights of the holders of the Preferred Stock of any series as may be determined by the Board of Directors before the issuance of any series of Preferred Stock.

B. Preferred Stock.

(1) General. Preferred Stock may be issued from time to time in one or more series, each to have such terms as are set forth herein and in the resolutions of the Board of Directors authorizing the issue of such series. Any shares of Preferred Stock which may be redeemed, purchased or otherwise acquired by the Corporation may be reissued. Different series of Preferred Stock shall not be construed to constitute different

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classes of shares for the purposes of voting by classes unless expressly so provided.

(2) Authority of Board of Directors. The Board of Directors may from time to time issue the Preferred Stock in one or more series. The Board of Directors may, in connection with the creation of any such series, determine the preferences, limitations and relative rights of each such series before the issuance of such series. Without limiting the foregoing, the Board of Directors may fix the voting powers, dividend rights, conversion rights, redemption privileges and liquidation preferences, all as the Board of Directors deems appropriate, to the full extent now or hereafter permitted by the Connecticut Business Corporation Act.

A-1

The resolutions providing for issuance of any series of Preferred Stock may provide that such series shall be superior or rank equally or be junior to the Preferred Stock of any other series to the extent permitted by law. Except as otherwise provided in this Certificate of Incorporation, no vote of the holders of the Preferred Stock or Common Stock shall be a prerequisite to the designation or issuance of shares of any series of the Preferred Stock authorized by and complying with the conditions of this Certificate of Incorporation and the Connecticut Business Corporation Act.

C. No shareholder of the Corporation shall by reason of his holding shares of capital stock of the Corporation have any preemptive or preferential rights to purchase or subscribe to any share of any class of stock of the Corporation, now or hereafter to be authorized, or to any notes, debentures, bonds or other securities (whether or not convertible into or carrying options or warrants to purchase shares of any class of capital stock) now or hereafter to be authorized, excepting only such preemptive or preferential rights, warrants or options as the Board of Directors in its discretion may grant from time to time; and the Board of Directors may issue shares of any class of stock of the Corporation, or any notes, debentures, bonds or other securities (whether or not convertible into or carrying rights, options or warrants to purchase shares of any class of capital stock) without offering any such shares to the existing Shareholders of the Corporation.

A-2

Exhibit B

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### TARP CAPITAL PURCHASE PROGRAM SENIOR PREFERRED STOCK AND WARRANTS

#### SUMMARY OF SENIOR PREFERRED TERMS

Issuer: Qualifying Financial Institution ("QFI") means (i) any U.S. bank or U.S. savings association not controlled by a Bank Holding Company ("BHC") or Savings and Loan Holding Company ("SLHC"); (ii) any U.S. BHC, or any U.S. SLHC which engages only in activities permitted for financial holdings companies under

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Section 4(k) of the Bank Holding Company Act, and any U.S. bank or U.S. savings association controlled by such a qualifying U.S. BHC or U.S. SLHC; and (iii) any U.S. BHC or U.S. SLHC whose U.S. depository institution subsidiaries are the subject of an application under Section 4(c)(8) of the Bank Holding Company Act; except that QFI shall not mean any BHC, SLHC, bank or savings association that is controlled by a foreign bank or company. For purposes of this program, "U.S. bank", "U.S. savings association", "U.S. BHC" and "U.S. SLHC" means a bank, savings association, BHC or SLHC organized under the laws of the United States or any State of the United States, the District of Columbia, any territory or possession of the United States, Puerto Rico, Northern Mariana Islands, Guam, American Samoa, or the Virgin Islands. The United States Department of the Treasury will determine eligibility and allocation for QFIs after consultation with the appropriate Federal banking agency.

Initial Holder: United States Department of the Treasury (the "UST").

Size: QFIs may sell preferred to the UST subject to the limits and terms described below.

Each QFI may issue an amount of Senior Preferred equal to not less than 1% of its risk-weighted assets and not more than the lesser of (i) \$25 billion and (ii) 3% of its risk-weighted assets.

Security: Senior Preferred, liquidation preference \$1,000 per share. (Depending upon the QFI's available authorized preferred shares, the UST may agree to purchase Senior Preferred with a higher liquidation preference per share, in which case the UST may require the QFI to appoint a depository to hold the Senior Preferred and issue depository receipts.)

Ranking: Senior to common stock and pari passu with existing preferred shares other than preferred shares which by their terms rank junior to any existing preferred shares.

Regulatory Capital Status: Tier 1.

Term: Perpetual life.

Dividend: The Senior Preferred will pay cumulative dividends at a rate of 5% per annum until the fifth anniversary of the date of this investment and thereafter at a rate of 9% per annum.

B-1

For Senior Preferred issued by banks which are not subsidiaries of holding companies, the Senior Preferred will pay non-cumulative dividends at a rate of 5% per annum until the fifth anniversary of the date of this investment and thereafter at a rate of 9% per annum. Dividends will be payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year.

Redemption: Senior Preferred may not be redeemed for a period of three years from the date of this investment, except with the proceeds from a Qualified Equity Offering (as defined below) which results in aggregate gross proceeds to the QFI of not less than 25% of the issue price of the Senior Preferred. After the third anniversary of the date of this investment, the Senior Preferred may be redeemed, in whole or in part, at any time and from time to time, at the option of the QFI. All redemptions of the Senior Preferred shall be at 100% of its issue price, plus (i) in the case of cumulative Senior Preferred, any accrued and unpaid dividends and (ii) in the case of noncumulative Senior Preferred, accrued and unpaid dividends for the then current dividend period (regardless of whether any dividends are actually declared for such dividend

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period), and shall be subject to the approval of the QFI's primary federal bank regulator.

"Qualified Equity Offering" shall mean the sale by the QFI after the date of this investment of Tier 1 qualifying perpetual preferred stock or common stock for cash.

Following the redemption in whole of the Senior Preferred held by the UST, the QFI shall have the right to repurchase any other equity security of the QFI held by the UST at fair market value.

Restrictions on Dividends: For as long as any Senior Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Senior Preferred, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Senior Preferred), nor may the QFI repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Senior Preferred or common shares, unless (i) in the case of cumulative Senior Preferred all accrued and unpaid dividends for all past dividend periods on the Senior Preferred are fully paid or (ii) in the case of non-cumulative Senior Preferred the full dividend for the latest completed dividend period has been declared and paid in full.

Common dividends: The UST's consent shall be required for any increase in common dividends per share until the third anniversary of the date of this investment unless prior to such third anniversary the Senior Preferred is redeemed in whole or the UST has transferred all of the Senior Preferred to third parties.

Repurchases: The UST's consent shall be required for any share repurchases (other than (i) repurchases of the Senior Preferred and (ii) repurchases of junior preferred shares or common shares in connection with any benefit plan in the ordinary course of business consistent with past practice) until the third anniversary of the date of this investment unless prior to such third anniversary the Senior Preferred is redeemed in whole or the UST has transferred all of the Senior Preferred to third parties. In addition, there shall be no share repurchases of junior preferred shares, preferred shares ranking pari passu with the Senior Preferred, or common shares if prohibited as described above under "Restrictions on Dividends".

B-2

Voting rights: The Senior Preferred shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Senior Preferred, (ii) any amendment to the rights of Senior Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Senior Preferred. If dividends on the Senior Preferred are not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

Transferability: The Senior Preferred will not be subject to any contractual restrictions on transfer. The QFI will file a shelf registration statement covering the Senior Preferred as promptly as practicable after the date of this investment and, if necessary, shall take all action required to cause such shelf registration statement to be declared effective as soon as possible. The QFI will also grant to the UST piggyback registration rights for the Senior Preferred and will take such other steps as may be reasonably requested to facilitate the transfer of the Senior Preferred including, if requested by the UST, using reasonable efforts to list the Senior Preferred on a national

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securities exchange. If requested by the UST, the QFI will appoint a depository to hold the Senior Preferred and issue depository receipts.

**Executive Compensation:** As a condition to the closing of this investment, the QFI and its senior executive officers covered by the EESA shall modify or terminate all benefit plans, arrangements and agreements (including golden parachute agreements) to the extent necessary to be in compliance with, and following the closing and for so long as UST holds any equity or debt securities of the QFI, the QFI shall agree to be bound by, the executive compensation and corporate governance requirements of Section 111 of the EESA and any guidance or regulations issued by the Secretary of the Treasury on or prior to the date of this investment to carry out the provisions of such subsection. As an additional condition to closing, the QFI and its senior executive officers covered by the EESA shall grant to the UST a waiver releasing the UST from any claims that the QFI and such senior executive officers may otherwise have as a result of the issuance of any regulations which modify the terms of benefits plans, arrangements and agreements to eliminate any provisions that would not be in compliance with the executive compensation and corporate governance requirements of Section 111 of the EESA and any guidance or regulations issued by the Secretary of the Treasury on or prior to the date of this investment to carry out the provisions of such subsection.

### SUMMARY OF WARRANT TERMS

**Warrant:** The UST will receive warrants to purchase a number of shares of common stock of the QFI having an aggregate market price equal to 15% of the Senior Preferred amount on the date of investment, subject to reduction as set forth below under "Reduction". The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, shall be the market price for the common stock on the date of the Senior Preferred investment (calculated on a 20-trading day trailing average), subject to customary anti-dilution adjustments. The exercise price shall be reduced by 15% of the original price on each six-month anniversary of the issue date of the warrants if the consent of the QFI stockholders described below has not been received, subject to a maximum reduction of 45% of the original exercise price.

B-3

**Term:** 10 years.

**Exercisability:** Immediately exercisable, in whole or in part.

**Transferability:** The warrants will not be subject to any contractual restrictions on transfer; provided that the UST may only transfer or exercise an aggregate of one-half of the warrants prior to the earlier of (i) the date on which the QFI has received aggregate gross proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualified Equity Offerings and (ii) December 31, 2009. The QFI will file a shelf registration statement covering the warrants and the common stock underlying the warrants as promptly as practicable after the date of this investment and, if necessary, shall take all action required to cause such shelf registration statement to be declared effective as soon as possible. The QFI will also grant to the UST piggyback registration rights for the warrants and the common stock underlying the warrants and will take such other steps as may be reasonably requested to facilitate the transfer of the warrants and the common stock underlying the warrants. The QFI will apply for the listing on the national exchange on which the QFI's common stock is traded of the common stock underlying the warrants and will take such other steps as may be reasonably requested to facilitate the transfer of the warrants or the common stock.

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Voting: The UST will agree not to exercise voting power with respect to any shares of common stock of the QFI issued to it upon exercise of the warrants.

Reduction: In the event that the QFI has received aggregate gross proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of common stock underlying the warrants then held by the UST shall be reduced by a number of shares equal to the product of (i) the number of shares originally underlying the warrants (taking into account all adjustments) and (ii) 0.5.

Consent: In the event that the QFI does not have sufficient available authorized shares of common stock to reserve for issuance upon exercise of the warrants and/or stockholder approval is required for such issuance under applicable stock exchange rules, the QFI will call a meeting of its stockholders as soon as practicable after the date of this investment to increase the number of authorized shares of common stock and/or comply with such exchange rules, and to take any other measures deemed by the UST to be necessary to allow the exercise of warrants into common stock.

Substitution: In the event the QFI is no longer listed or traded on a national securities exchange or securities association, or the consent of the QFI stockholders described above has not been received within 18 months after the issuance date of the warrants, the warrants will be exchangeable, at the option of the UST, for senior term debt or another economic instrument or security of the QFI such that the UST is appropriately compensated for the value of the warrant, as determined by the UST.

B-4

[X] PLEASE MARK VOTES AS IN THIS EXAMPLE

REVOCABLE PROXY  
SALISBURY BANCORP, INC.

THIS PROXY SOLICITED ON BEHALF OF  
THE BOARD OF DIRECTORS OF SALISBURY BANCORP, INC.

The undersigned holder(s) of the Common Stock of Salisbury Bancorp, Inc. (the "Company") do hereby nominate, constitute and appoint \_\_\_\_\_ and \_\_\_\_\_ jointly and severally, proxies with full power of substitution, for us and in our name, place and stead to vote all the Common Stock of the Company, standing in our name on February 4, 2009 at the Special Meeting of its Shareholders to be held at The Interlaken Inn, 74 Interlaken Road, Route 112, Lakeville, Connecticut on Tuesday, March 10, 2009 at 10:00 a.m. or any adjournment thereof with all the powers the undersigned would possess if personally present, as follows:

- (1) APPROVAL of an amendment to the Company's Certificate of Incorporation to authorize 25,000 shares of preferred stock, par value \$0.01 per share.

FOR	AGAINST	ABSTAIN
[ ]	[ ]	[ ]

- (2) OTHER BUSINESS: To conduct whatever other business may properly be brought before the Special Meeting or any adjournment thereof. Management at present knows of no other business to be presented by or on behalf of the Company or its Management at the Special Meeting. In the event that any other business requiring a vote of the Shareholders is properly presented

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at the Special Meeting, the holders of the proxies will vote your shares in accordance with their best judgment and the recommendations of a majority of the Board of Directors.

PLEASE CHECK THE BOX IF YOU PLAN TO ATTEND THE MEETING [ ]

Please be sure to sign and date this Proxy in the box below. Date \_\_\_\_\_, 2009

-----
Shareholder sign above Co-holder (if any) sign above
-----

-----
Detach above card, date, sign and mail in postage-prepaid envelope provided.
-----

SALISBURY BANCORP, INC.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" PROPOSAL (1).

THIS PROXY WILL BE VOTED IN ACCORDANCE WITH THE SPECIFICATION INDICATED. IF NO SPECIFICATION IS INDICATED, THIS PROXY WILL BE VOTED "FOR" PROPOSAL (1) AND IN ACCORDANCE WITH THE DETERMINATION OF A MAJORITY OF THE BOARD OF DIRECTORS AS TO OTHER MATTERS.

All joint owners must sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title. If more than one trustee, all must sign.

THIS PROXY MAY BE REVOKED AT ANY TIME PRIOR TO THE MEETING BY PROVIDING WRITTEN NOTICE TO THE COMPANY SECRETARY OR MAY BE WITHDRAWN AND YOU MAY VOTE IN PERSON SHOULD YOU ATTEND THE SPECIAL MEETING.

PLEASE ACT PROMPTLY
SIGN, DATE & MAIL YOUR PROXY CARD TODAY

-----
IF YOUR ADDRESS HAS CHANGED, PLEASE CORRECT THE ADDRESS IN THE SPACE PROVIDED BELOW AND RETURN THIS PORTION WITH THE PROXY IN THE ENVELOPE PROVIDED.
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Table with financial data including CURRENT LIABILITIES, NONCURRENT LIABILITIES, STOCKHOLDERS' EQUITY, and TOTAL LIABILITIES AND EQUITY.

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





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

	SIX MONTHS ENDED JUNE 30,		THREE MONTHS ENDED JUNE 30,	
	2017	2016	2017	2016
Revenue				
Sales of systems	\$-	\$-	\$-	\$-
Contingent rental income	-	6,759	-	-
Total revenue	-	6,759	-	-
Cost of sales				
Cost of systems and contingent rental income	-	8,125	-	-
Gross profit (loss)	-	(1,366 )	-	-
Interest income on sales-type leases	4,331,011	8,659,829	2,202,995	3,778,299
Total operating income	4,331,011	8,658,463	2,202,995	3,778,299
Operating expenses				
General and administrative	339,301	854,784	230,240	365,371
Total operating expenses	339,301	854,784	230,240	365,371
Income from operations	3,991,710	7,803,679	1,972,755	3,412,928
Non-operating income (expenses)				
Interest income	70,877	63,502	34,844	31,814
Interest expense	(2,722,742)	(3,381,989)	(1,365,532)	(2,032,419)
Loss on sale of construction in progress of Xuzhou Zhongtai	-	(2,822,679)	-	-
Loss on systems repurchase from Yida	-	(417,952 )	-	(417,952 )
Other income	7,798	76,418	3,275	74,091
Total non-operating expenses, net	(2,644,067)	(6,482,700)	(1,327,413)	(2,344,466)
Income before income tax	1,347,643	1,320,979	645,342	1,068,462
Income tax expense (benefit)	781,966	(972,768 )	365,663	(1,183,539)
Income before noncontrolling interest	565,677	2,293,747	279,679	2,252,001

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Less: income attributable to noncontrolling interest	(178,255 )	(147,205 )	(89,832 )	(95,925 )
Net income attributable to China Recycling Energy Corporation	743,932	2,440,952	369,511	2,347,926
Other comprehensive items				
Foreign currency translation gain (loss) attributable to China Recycling Energy Corporation	4,632,435	(4,499,312)	3,526,451	(5,568,969)
Foreign currency translation gain (loss) attributable to noncontrolling interest	(5,686 )	21,556	(5,132 )	21,021
Comprehensive income (loss) attributable to China Recycling Energy Corporation	\$5,376,367	\$(2,058,360)	\$3,895,962	\$(3,221,043)
Comprehensive loss attributable to noncontrolling interest	\$(183,941 )	\$(125,649 )	\$(94,964 )	\$(74,904 )
Basic and diluted weighted average shares outstanding	8,310,198	8,310,159	8,310,198	8,310,159
Basic and diluted earnings per share	\$0.09	\$0.29	\$0.04	\$0.28

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

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

	SIX MONTHS ENDED	
	JUNE 30,	
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Income including noncontrolling interest	\$565,677	\$2,293,747
Adjustments to reconcile income including noncontrolling interest to net cash provided by (used in) operating activities:		
Depreciation and amortization	760	3,156
Stock option expense	4,647	-
Investment income	(87,331 )	(105,975 )
Changes in deferred tax	117,315	(1,878,676 )
Loss on sales of construction in progress of Xuzhou Zhongtai	-	2,822,679
Changes in assets and liabilities:		
Interest receivable on sales type leases	(2,922,393 )	(957,028 )
Collection of principal on sales type leases	574,006	19,668,078
Prepaid expenses	578,292	794,023
Accounts receivable	-	(19,809,197)
Other receivables	(1,692,112 )	(181,410 )
Notes receivable	(786,061 )	-
Construction in progress	(1,575,823 )	22,051,212
Accounts payable	661,102	271,044
Taxes payable	(51,783 )	128,935
Interest payable on entrusted loan	3,722,719	(24,299 )
Accrued liabilities and other payables	(291,187 )	(1,014,498 )
Net cash provided by (used in) operating activities	(1,182,172 )	24,061,791
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Changes of restricted cash	-	572,715
Net cash provided by investing activities	-	572,715
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of loans	(727,834 )	(22,755,463)
Advance from related parties	-	274
Net cash used in financing activities	(727,834 )	(22,755,189)

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EFFECT OF EXCHANGE RATE CHANGE ON CASH AND EQUIVALENTS	1,133,676	(891,989 )
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(776,330 )	987,328
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	47,752,353	41,749,388
CASH AND EQUIVALENTS, END OF PERIOD	\$46,976,023	\$42,736,716
Supplemental cash flow data:		
Income tax paid	\$1,128,756	\$697,232
Interest paid	\$14,363	\$5,944,795

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

## CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017 (UNAUDITED) AND DECEMBER 31, 2016

#### 1. ORGANIZATION AND DESCRIPTION OF BUSINESS

China Recycling Energy Corporation (the “Company” or “CREG”) was incorporated on May 8, 1980 as Boulder Brewing Company under the laws of the State of Colorado. On September 6, 2001, the Company changed its state of incorporation to the Nevada. In 2004, the Company changed its name from Boulder Brewing Company to China Digital Wireless, Inc. and on March 8, 2007, again changed its name from China Digital Wireless, Inc. to its current name, China Recycling Energy Corporation. The Company, through its subsidiaries, provides energy saving solutions and services, including selling and leasing energy saving systems and equipment to customers, project investment, investment management, economic information consulting, technical services, financial leasing, purchase of financial leasing assets, disposal and repair of financial leasing assets, consulting and ensuring of financial leasing transactions in the Peoples Republic of China (“PRC”).

##### *Erdos TCH – Joint Venture*

On April 14, 2009, the Company formed a joint venture (the “JV”) with Erdos Metallurgy Co., Ltd. (“Erdos”) to recycle waste heat from Erdos’ metal refining plants to generate power and steam to be sold back to Erdos. The name of the JV was Inner Mongolia Erdos TCH Energy Saving Development Co., Ltd. (“Erdos TCH”) with a term of 20 years. Total investment for the project was estimated at \$79 million (RMB 500 million) with an initial investment of \$17.55 million (RMB 120 million). Erdos contributed 7% of the total investment of the project, and Xi’an TCH Energy Technology Co., Ltd. (“Xi’an TCH”) contributed 93%. According to the parties’ agreement on profit distribution, Xi’an TCH and Erdos will receive 80% and 20%, respectively, of the profit from the JV until Xi’an TCH receives the complete return of its investment. Xi’an TCH and Erdos will then receive 60% and 40%, respectively, of the profit from the JV. On June 15, 2013, Xi’an TCH and Erdos entered into a share transfer agreement, pursuant to which Erdos sold its 7% ownership interest in the JV to Xi’an TCH for \$1.29 million (RMB 8 million), plus certain accumulated profits as described below. Xi’an TCH paid the \$1.29 million in July 2013 and, as a result, became the sole stockholder of the JV. In addition, Xi’an TCH paid Erdos accumulated profits from inception up to June 30, 2013 in accordance with a supplementary agreement entered on August 6, 2013. In August 2013, Xi’an TCH paid 20% of the accumulated profit (calculated under PRC GAAP) of \$226,000 to Erdos. Erdos TCH currently has two power generation systems in Phase I with a total of 18 MW power capacity, and three power generation systems in Phase II with a total of 27 MW power capacity. On April 28, 2016, Erdos TCH and Erdos entered a supplemental agreement, effective on May 1, 2016, Erdos TCH cancelled monthly minimum lease payments from Erdos, and charges Erdos based on actual electricity sold at RMB 0.30 / KWH. The selling price of each KWH will be determined annually based on prevailing market conditions.

*Pucheng Biomass Power Generation Projects*

On June 29, 2010, Xi'an TCH entered into a Biomass Power Generation ("BMPG") Project Lease Agreement with PuchengXinHeng Yuan Biomass Power Generation Co., Ltd. ("Pucheng"), a limited liability company incorporated in China. Under this lease agreement, Xi'an TCH leased a set of 12 MW BMPG systems to Pucheng at a minimum of \$279,400 (RMB 1,900,000) per month for 15 years.

On September 11, 2013, Xi'an TCH entered into a BMPG Asset Transfer Agreement (the "Pucheng Transfer Agreement") with Pucheng. The Pucheng Transfer Agreement provided for the sale by Pucheng to Xi'an TCH of a set of 12 MW BMPG systems with completion of system transformation for RMB 100 million (\$16.48 million) in the form of 8,766,547 shares of common stock of the Company at \$1.87 per share. These shares were issued to Pucheng on October 29, 2013. Also on September 11, 2013, Xi'an TCH entered into a BMPG Project Lease Agreement with Pucheng (the "Pucheng Lease"). Under the Pucheng Lease, Xi'an TCH leases this same set of 12 MW BMPG system to Pucheng, and combined this lease with the lease for the 12 MW BMPG station of Pucheng Phase I project, under a single lease to Pucheng for RMB 3.8 million (\$0.63 million) per month (the "Pucheng Phase II Project"). The term for the combined lease is from September 2013 to June 2025. The lease agreement for the 12 MW station from Pucheng Phase I project terminated upon the effective date of the Pucheng Lease. The ownership of two 12 MW BMPG systems will transfer to Pucheng at no additional charge when the Pucheng Lease expires.

*Shenqiu Yuneng Biomass Power Generation Projects*

On May 25, 2011, Xi'an TCH entered into a Letter of Intent with ShenqiuYuNeng Thermal Power Co., Ltd. ("Shenqiu") to reconstruct and transform a Thermal Power Generation System owned by Shenqiu into a 75T/H BMPG System for \$3.57 million (RMB 22.5 million). The project commenced in June 2011 and was completed in the third quarter of 2011. On September 28, 2011, Xi'an TCH entered into a BMPG Asset Transfer Agreement with Shenqiu (the "Shenqiu Transfer Agreement"). Pursuant to the Shenqiu Transfer Agreement, Shenqiu sold Xi'an TCH a set of 12 MW BMPG systems (after Xi'an TCH converted the system for BMPG purposes). As consideration for the BMPG systems, Xi'an TCH agreed to pay Shenqiu \$10,937,500 (RMB 70 million) in cash in three installments within six months upon the transfer of ownership of the systems. By the end of 2012, all the consideration was paid. On September 28, 2011, Xi'an TCH and Shenqiu also entered into a BMPG Project Lease Agreement (the "2011 Shenqiu Lease"). Under the 2011 Shenqiu Lease, Xi'an TCH agreed to lease a set of 12 MW BMPG systems to Shenqiu at a monthly rental rate of \$286,000 (RMB 1,800,000) for 11 years. Upon expiration of the 2011 Shenqiu Lease, ownership of this system will transfer from Xi'an TCH to Shenqiu at no additional cost. In connection with the 2011 Shenqiu Lease, Shenqiu paid one month's rent as a security deposit to Xi'an TCH, in addition to providing personal guarantees.

On October 8, 2012, Xi'an TCH entered into a Letter of Intent for technical reformation of Shenqiu Project Phase II with Shenqiu for technical reformation to enlarge the capacity of the Shenqiu Project Phase I (the "Shenqiu Phase II Project"). The technical reformation involved the construction of another 12 MW BMPG system. After the reformation, the generation capacity of the power plant increased to 24 MW. The project commenced on October 25, 2012 and was completed during the first quarter of 2013. The total cost of the project was \$11.1 million (RMB 68 million). On March 30, 2013, Xi'an TCH and Shenqiu entered into a BMPG Project Lease Agreement (the "2013 Shenqiu Lease"). Under the 2013 Shenqiu Lease, Xi'an TCH agreed to lease the second set of 12 MW BMPG systems to Shenqiu for \$239,000 (RMB 1.5 million) per month for 9.5 years. When the 2013 Shenqiu Lease expires, ownership of this system will transfer from Xi'an TCH to Shenqiu at no additional cost.

*Yida Coke Oven Gas Power Generation Projects*

On June 28, 2014, Xi'an TCH entered into an Asset Transfer Agreement (the "Transfer Agreement") with Qitaihe City Boli Yida Coal Selection Co., Ltd. ("Yida"), a limited liability company incorporated in China. The Transfer Agreement provided for the sale to Xi'an TCH of a 15 MW coke oven gas power generation station, which had been converted from a 15 MW coal gangue power generation station from Yida. As consideration for the Transfer Asset, Xi'an TCH was to pay to Yida RMB 115 million (\$18.69 million) in the form of the common stock shares of the Company at the average closing price per share of the Stock for the 10 trading days prior to the closing date of the transaction (\$2.27 per share). The exchange rate between the US Dollar and Chinese RMB in connection with the stock issuance is the rate equal to the middle rate published by the People's Bank of China on the closing date of the assets transfer. Accordingly, the Company issued 8,233,779 shares (the "Shares") for the Yida 15 MW coke oven gas power generation station, the fair value of 8,233,779 shares was \$14.49 million based on the stock price at the agreement date (\$1.76 per share), and was the cost of the power generation station.

On June 28, 2014, Xi'an TCH also entered into a Coke Oven Gas Power Generation Project Lease Agreement (the "Lease Agreement") with Yida. Under the Lease Agreement, Xi'an TCH leased the Transfer Asset to Yida for RMB 3 million (\$0.49 million) per month, and the term of the lease is from June 28, 2014 to June 27, 2029. Yida provided an RMB 3 million (\$0.49 million) security deposit (without interest) for the lease. Xi'an TCH will transfer the Transfer Asset back to Yida at no cost at the end of the lease term.

On June 22, 2016, Xi'an TCH entered into a Coal Oven Gas Power Generation Project Repurchase Agreement (the "Repurchase Agreement") with Yida. Under the Repurchase Agreement, Xi'an TCH agreed to transfer to Yida all the project assets for RMB 112,000,000 (\$16.89 million) (the "Transfer Price") with Yida's retention of ownership of the Shares. Yida agreed to make the following payments: (i) the outstanding monthly leasing fees for April and May 2016 in total of RMB 6,000,000 (\$0.90 million) to Xi'an TCH within 5 business days from the execution of the Repurchase Agreement; (ii) a payment of RMB 50,000,000 (\$7.54 million) of the Transfer Price to Xi'an TCH within 5 business days from the execution of the Repurchase Agreement; and (iii) a payment of the remaining RMB 62,000,000 (\$9.35 million) of the Transfer Price to Xi'an TCH within 15 business days from the execution of the Repurchase Agreement. Under the Repurchase Agreement, ownership of the project assets will transfer from Xi'an TCH to Yida within 3 business days after Xi'an TCH receives the full Transfer Price and the outstanding monthly leasing fees. In July 2016, the Company received the full payment of the Transfer Price and title to the system was transferred at that time. The Company recorded a \$0.42 million loss from this transaction in 2016.



*The Fund Management Company*

On June 25, 2013, Xi'an TCH and HongyuanHuifu Venture Capital Co. Ltd. ("HongyuanHuifu") jointly established Hongyuan Recycling Energy Investment Management Beijing Co., Ltd. (the "Fund Management Company") with registered capital of RMB 10 million (\$1.45 million). Xi'an TCH made an initial capital contribution of RMB 4 million (\$650,000) and has a 40% ownership interest in the Fund Management Company. With respect to the Fund Management Company, voting rights and dividend rights are allocated 80% and 20% between HongyuanHuifu and Xi'an TCH, respectively.

The Fund Management Company is the general partner of Beijing Hongyuan Recycling Energy Investment Center, LLP (the "HYREF Fund"), a limited liability partnership established on July 18, 2013 in Beijing. The Fund Management Company made an initial capital contribution of RMB 5 million (\$830,000) to the HYREF Fund. An initial total of RMB 460 million (\$75 million) was fully subscribed by all partners for the HYREF Fund. The HYREF Fund has three limited partners: (1) China Orient Asset Management Co., Ltd., which made an initial capital contribution of RMB 280 million (\$46.67 million) to the HYREF Fund and is a preferred limited partner; (2) HongyuanHuifu, which made an initial capital contribution of RMB 100 million (\$16.67 million) to the HYREF Fund and is an ordinary limited partner; and (3) the Company's wholly-owned subsidiary, Xi'an TCH, which made an initial capital contribution of RMB 75 million (\$12.5 million) to the HYREF Fund and is a secondary limited partner. The term of the HYREF Fund's partnership is six years from the date of its establishment, expiring July 18, 2019. The current term is four years from the date of contribution for the preferred limited partner, and four years from the date of contribution for the ordinary limited partner. The total size of the HYREF Fund is RMB 460 million (\$76.66 million). The HYREF Fund was formed for the purpose of investing in Xi'an Zhonghong New Energy Technology Co., Ltd., a 90% owned subsidiary of Xi'an TCH, for the construction of two coke dry quenching ("CDQ") WHPG stations with Jiangsu Tianyu Energy and Chemical Group Co., Ltd. ("Tianyu") and one CDQ WHPG station with Boxing County Chengli Gas Supply Co., Ltd. ("Chengli").

*Chengli Waste Heat Power Generation Projects*

On July 19, 2013, Xi'an TCH formed a new company, "Xi'an Zhonghong New Energy Technology Co., Ltd." ("Zhonghong"), with registered capital of RMB 30 million (\$4.85 million). Xi'an TCH paid RMB 27 million (\$4.37 million) and owns 90% of Zhonghong. Zhonghong is engaged to provide energy saving solution and services, including constructing, selling and leasing energy saving systems and equipment to customers.

On July 24, 2013, Zhonghong entered into a Cooperative Agreement of CDQ and CDQ WHPG Project with Boxing County Chengli Gas Supply Co., Ltd. ("Chengli"). The parties entered into a supplement agreement on July 26, 2013. Pursuant to these agreements, Zhonghong will design, build and maintain a 25 MW CDQ system and a CDQ WHPG system to supply power to Chengli, and Chengli will pay energy saving fees (the "Chengli Project"). Chengli will

contract the operation of the system to a third-party contractor that is mutually agreed to by Zhonghong. In addition, Chengli will provide the land for the CDQ system and CDQ WHPG system at no cost to Zhonghong. The term of the Agreements is for 20 years. The first 800 million watt hours generated by the Chengli Project will be charged at RMB 0.42 (\$0.068) per kilowatt hour (excluding tax); thereafter, the energy saving fee will be RMB 0.20 (\$0.036) per kilowatt hour (excluding tax). The operating time shall be based upon an average 8,000 hours annually. If the operating time is less than 8,000 hours per year for either Xuzhou Tian'an or Xuzhou Huayu due to a reason attributable to Chengli, then time charged shall be 8,000 hours a year, and if it is less than 8,000 hours due to a reason attributable to Zhonghong, then it shall be charged at actual operating hours. The construction of the Chengli Project was completed in the second quarter of 2015 and the project successfully completed commissioning tests in the first quarter of 2017. The Chengli Project is now operational, but will not begin operations until the Company receives the required power generating license, which the Company anticipates receiving in the third quarter of 2017. When operations begin, Chengli shall ensure its coking production line works properly and that working hours for the CDQ system are at least 8,000 hours per year, and Zhonghong shall ensure that working hours for the CDQ WHPG system are at least 7,200 hours per year.

On July 22, 2013, Zhonghong entered into an Engineering, Procurement and Construction (“EPC”) General Contractor Agreement for the Boxing County Chengli Gas Supply Co., Ltd. CDQ Power Generation Project (the “Huaxin Project”) with Xi’an Huaxin New Energy Co., Ltd. (“Huaxin”). Zhonghong, as the owner of the Huaxin Project, contracted EPC services for a CDQ system and a 25 MW CDQ WHPG system for Chengli from Huaxin. Huaxin shall provide construction, equipment procurement, transportation, installation and adjustment, test run, construction engineering management and other necessary services to complete the Huaxin Project and ensure the CDQ system and CDQ WHPG system for Chengli meet the inspection and acceptance requirements and work normally. The Huaxin Project is a turn-key project where Huaxin is responsible for monitoring the quality, safety, duration and cost of the Chengli Project. The total contract price is RMB 200 million (\$33.34 million), which includes all the materials, equipment, labor, transportation, electricity, water, waste disposal, machinery and safety costs.

#### *Tianyu Waste Heat Power Generation Project*

On July 19, 2013, Zhonghong entered into a Cooperative Agreement (the “Tianyu Agreement”) for Energy Management of CDQ and CDQ WHPG Project with Jiangsu Tianyu Energy and Chemical Group Co., Ltd. (“Tianyu”). Pursuant to the Tianyu Agreement, Zhonghong will design, build, operate and maintain two sets of 25 MW CDQ systems and CDQ WHPG systems for two subsidiaries of Tianyu – Xuzhou Tian’an Chemical Co., Ltd. (“Xuzhou Tian’an”) and Xuzhou Huayu Coking Co., Ltd. (“Xuzhou Huayu”) – to be located at Xuzhou Tian’an and Xuzhou Huayu’s respective locations (the “Tianyu Project”). Upon completion of the Tianyu Project, Zhonghong will charge Tianyu an energy saving fee of RMB 0.534 (\$0.087) per kilowatt hour (excluding tax). The operating time will be based upon an average 8,000 hours annually for each of Xuzhou Tian’an and Xuzhou Huayu. If the operating time is less than 8,000 hours per year due to a reason attributable to Tianyu, then time charged will be 8,000 hours a year. The term of the Tianyu Agreement is 20 years. The construction of the Xuzhou Tian’an Project is anticipated to be completed by the third quarter of 2017. Xuzhou Tian’an will provide the land for the CDQ and CDQ WHPG systems for free. Xuzhou Tian’an also guarantees that it will purchase all the power generated by the CDQ WHPG systems. The Xuzhou Huayu Project is currently on hold due to a conflict between Xuzhou Huayu Coking Co., Ltd. and local residents on certain pollution-related issues. The local government has acted in its capacity to coordinate the resolution of this issue. The local residents were requested to move from the hygienic buffer zone of the project location with compensatory payments from the government. Xuzhou Huayu was required to stop production and implement technical innovations to mitigate pollution discharge including sewage treatment, dust collection, noise control, and recycling of coal gas. Currently, some local residents have moved. Xuzhou Huayu has completed the implementation of the technical innovations of sewage treatment, dust collection, and noise control, and the Company is waiting for local governmental agencies to approve these technical innovations so that we can resume construction. We expect to complete the recycling of coal gas in the first half of 2018. Once Huayu obtains the government’s acceptance and approval of the technical innovations, the project will resume.

On July 22, 2013, Zhonghong entered into an EPC General Contractor Agreement for the Tianyu Project with Xi’an Huaxin New Energy Co., Ltd. (“Huaxin”). Zhonghong, as the owner of the Tianyu Project, contracted EPC services for two CDQ systems and two 25 MW CDQ WHPG systems for Tianyu to Huaxin. Huaxin shall provide construction, equipment procurement, transportation, installation and adjustment, test run, construction engineering management and other necessary services to complete the Tianyu Project and ensure the CDQ and CDQ WHPG systems for Tianyu

meet the inspection and acceptance requirements and work normally. The Tianyu Project is a turn-key project where Huaxin is responsible for monitoring the quality, safety, duration and cost of the project. The total contract price is RMB 400 million (\$66.68 million), which includes all the materials, equipment, labor, transportation, electricity, water, waste disposal, machinery and safety costs.

*Zhongtai Waste Heat Power Generation Energy Management Cooperative Agreement*

On December 6, 2013, Xi'an entered into a CDQ and WHPG Energy Management Cooperative Agreement (the "Zhongtai Agreement") with Xuzhou Zhongtai Energy Technology Co., Ltd. ("Zhongtai"), a limited liability company incorporated in Jiangsu Province, China.

Pursuant to the Zhongtai Agreement, Xi'an TCH will design, build and maintain a 150 ton per hour CDQ system and a 25 MW CDQ WHPG system and sell the power to Zhongtai, and Xi'an TCH will also build a furnace to generate steam from the waste heat of the smoke pipeline and sell the steam to Zhongtai.

The construction period of the Project is expected to be 18 months from the date when conditions are ready for construction to begin. Zhongtai will start to pay an energy saving service fee from the date when the WHPG station passes the required 72-hour test run. The payment term is 20 years. For the first 10 years, Zhongtai shall pay an energy saving fee at RMB 0.534 (\$0.089) per kilowatt hour (KWH) (including value added tax) for the power generated from the system. For the second 10 years, Zhongtai shall pay an energy saving fee at RMB 0.402 (\$0.067) per KWH (including value added tax). During the term of the contract the energy saving fee shall be adjusted at the same percentage as the change of local grid electricity price. Zhongtai shall also pay an energy saving fee for the steam supplied by Xi'an TCH at RMB 100 (\$16.67) per ton (including value added tax). Zhongtai and its parent company will provide guarantees to ensure Zhongtai will fulfill its obligations under the Agreement. Upon the completion of the term, Xi'an TCH will transfer the systems to Zhongtai at RMB 1 (\$0.16). Zhongtai shall provide waste heat to the systems for no less than 8,000 hours per year and waste gas volume no less than 150,000 Normal Meter Cubed (Nm<sup>3</sup>) per hour with a temperature no less than 950°C. If these requirements are not met, the term of the Agreement will be extended accordingly. If Zhongtai wants to terminate the Zhongtai Agreement early, it shall provide Xi'an TCH a 60 day notice and pay the termination fee and compensation for the damages to Xi'an TCH according to the following formula: (1) if it is less than five years into the term when Zhongtai requests termination, Zhongtai shall pay: Xi'an TCH's total investment amount plus Xi'an TCH's annual investment return times five years minus the years in which the system has already operated); or 2) if it is more than five years into the term when Zhongtai requests the termination, Zhongtai shall pay: Xi'an TCH's total investment amount minus total amortization cost (the amortization period is 10 years).

In March 2016, Xi'an TCH entered into a Transfer Agreement of CDQ and a CDQ WHPG system with Zhongtai and Xi'an Huaxin (the "Transfer Agreement"). Under the Transfer Agreement, Xi'an TCH agreed to transfer to Zhongtai all of the assets associated with the CDQ Waste Heat Power Generation Project (the "Project"), which is under construction pursuant to the Zhongtai Agreement. Xi'an Huaxin will continue to construct and complete the Project and Xi'an TCH agreed to transfer all its rights and obligation under the "EPC" Contract to Zhongtai. As consideration for the transfer of the Project, Zhongtai agreed to pay to Xi'an TCH an aggregate transfer price of RMB 167,360,000 (\$25.77 million) including payments of: (i) RMB 152,360,000 (\$23.46 million) for the construction of the Project; and (ii) RMB 15,000,000 (\$2.31 million) as payment for partial loan interest accrued during the construction period. Those amounts have been, or will be, paid by Zhongtai to Xi'an TCH according to the following schedule: (a) RMB 50,000,000 (\$7.70 million) was paid within 20 business days after the Transfer Agreement was signed; (b) RMB 30,000,000 (\$4.32 million) was paid within 20 business days after the Project is completed, but no later than July 30, 2016; and (c) RMB 87,360,000 (\$13.45 million) will be paid no later than July 30, 2017. Xuzhou Taifa Special Steel Technology Co., Ltd. ("Xuzhou Taifa") guaranteed the payments from Zhongtai to Xi'an TCH. The ownership of the Project was conditionally transferred to Zhongtai following the initial payment of RMB 50,000,000 (\$7.70 million) by Zhongtai to Xi'an TCH and the full ownership of the Project will be officially transferred to Zhongtai after it completes all payments pursuant to the Transfer Agreement. As of June 30, 2017, Xi'an TCH had received the first payment of \$7.70 million and the second payment of \$4.32 million. The Company recorded a \$2.82 million loss from this transaction in 2016. As of this report date, the Company has not yet received the remaining payment of RMB 87,360,000 (\$13.45 million), the Company expects to collect this remaining balance during the third quarter of 2017.

*Rongfeng CDQ Power Generation Energy Management Cooperative Agreement*

On December 12, 2013, Xi'an TCH entered into a CDQ Power Generation Energy Management Cooperative Agreement with Tangshan Rongfeng Iron & Steel Co., Ltd. (the "Rongfeng Agreement"), a limited liability company incorporated in Hebei Province, China.

Pursuant to the Rongfeng Agreement, Xi'an TCH will design, build and maintain a CDQ and a CDQ WHPG system and sell the power to Rongfeng. The construction period of the Project is expected to be 18 months after the Agreement takes effect and from the date when conditions are ready for construction to begin.

Rongfeng will start to pay an energy saving fee from the date when the WHPG station passes the required 72-hour test run. The payment term is 20 years. For the first 10 years, Rongfeng shall pay an energy saving fee at RMB 0.582 (\$0.095) per KWH (including tax) for the power generated from the system. For the second 10 years, Rongfeng shall pay an energy saving fee at RMB 0.432 (\$0.071) per KWH (including tax). During the term of the contract the energy saving fee shall be adjusted at the same percentage as the change of local grid electricity price. Rongfeng and its parent company will provide guarantees to ensure Rongfeng will fulfill its obligations under the Rongfeng Agreement. Upon the completion of the term, Xi'an TCH will transfer the systems to Rongfeng at RMB 1. Rongfeng shall provide waste heat to the systems for no less than 8,000 hours per year with a temperature no less than 950°C. If these requirements are not met, the term of the Agreement will be extended accordingly. If Rongfeng wants to terminate the Agreement early, it shall provide Xi'an TCH a 60 day notice and pay the termination fee and compensation for the damages to Xi'an TCH according to the following formula: 1) if it is less than five years (including five years) into the term when Rongfeng requests termination, Rongfeng shall pay: Xi'an TCH's total investment amount plus Xi'an TCH's average annual investment return times (five years minus the years of which the system has already operated); 2) if it is more than five years into the term when Rongfeng requests the termination, Rongfeng shall pay: Xi'an TCH's total investment amount minus total amortization cost (the amortization period is 10 years). On November 16, 2015, Xi'an TCH entered into a Transfer Agreement of CDQ and a CDQ WHPG system with Rongfeng and Xi'an Huaxin New Energy Co., Ltd., a limited liability company incorporated in China ("Xi'an Huaxin"). The Transfer Agreement provided for the sale to Rongfeng of the CDQ Waste Heat Power Generation Project (the "Project") from Xi'an TCH. Additionally, Xi'an TCH would transfer to Rongfeng the Engineering, Procurement and Construction ("EPC") Contract for the CDQ Waste Heat Power Generation Project which Xi'an TCH had entered into with Xi'an Huaxin in connection with the Project. As consideration for the transfer of the Project, Rongfeng is to pay to Xi'an TCH an aggregate purchase price of RMB 165,200,000 (\$25.45 million), whereby (a) RMB 65,200,000 (\$10.05 million) was to be paid by Rongfeng to Xi'an TCH within 20 business days after signing the Transfer Agreement, (b) RMB 50,000,000 (\$7.70 million) was paid by Rongfeng to Xi'an TCH within 20 business days after the Project is completed, but no later than March 31, 2016 and (c) RMB 50,000,000 (\$7.70 million) was to be paid by Rongfeng to Xi'an TCH no later than September 30, 2016. Mr. Cheng Li, the largest stockholder of Rongfeng, has personally guaranteed the payments. The ownership of the Project was conditionally transferred to Rongfeng within 3 business days following the initial payment of RMB 65,200,000 (\$10.05 million) by Rongfeng to Xi'an TCH and the full ownership of the Project will be officially transferred to Rongfeng after it completes the entire payment pursuant to the Transfer Agreement. The Company recorded a \$3.78 million loss from this transaction in 2015. As of December 31, 2016, the Company had received full payment of \$25.45 million.

#### *Formation of Zhongxun*

On March 24, 2014, Xi'an TCH incorporated a new subsidiary, Zhongxun Energy Investment (Beijing) Co., Ltd ("Zhongxun") with registered capital of \$5,695,502 (RMB 35,000,000), which must be contributed before October 1, 2028. Zhongxun is 100% owned by Xi'an TCH and will be mainly engaged in project investment, investment management, economic information consulting, and technical services. Zhongxun has not yet commenced operations as of the date of this report.

#### *Formation of Yinghua*

On February 11, 2015, the Company incorporated a new subsidiary, Shanghai Yinghua Financial Leasing Co., Ltd (“Yinghua”) with registered capital of \$30,000,000, to be paid within 10 years from the date the business license is issued. Yinghua is 100% owned by the Company and will be mainly engaged in financial leasing, purchase of financial leasing assets, disposal and repair of financial leasing assets, consulting and ensuring of financial leasing transactions, and related factoring business. Yinghua has not yet commenced operations as of the date of this report.

*Summary of Sales-Type Lease at June 30, 2017*

*Status at June 30, 2017*

As of June 30, 2017, Xi’an TCH leases the following systems: (i) BMPG systems to Pucheng Phase I and II (15 and 11 year terms, respectively); (ii) BMPG systems to Shenqiu Phase I (11-year term); and (iii) Shenqiu Phase II (9.5-year term). In addition, as of June 30, 2017, Erdos TCH leased power and steam generating systems for recycling waste heat from metal refining to Erdos (five systems) for a term of 20 years.



*Asset Repurchase Agreement*

During the six months ended June 30, 2017 and the year ended December 31, 2016, the Company entered into the following Asset Repurchase Agreements:

In March 2016, Xi'an TCH entered into a Transfer Agreement of CDQ and a CDQ WHPG system with Zhongtai and Xi'an Huaxin (the "Transfer Agreement"). Under the Transfer Agreement, Xi'an TCH agreed to transfer to Zhongtai all of the assets associated with the CDQ Waste Heat Power Generation Project (the "Project"), which is under construction pursuant to the Zhongtai Agreement. Xi'an Huaxin will continue to construct and complete the Project and Xi'an TCH agreed to transfer all its rights and obligation under the "EPC" Contract to Zhongtai. As consideration for the transfer of the Project, Zhongtai agreed to pay to Xi'an TCH an aggregate transfer price of RMB 167,360,000 (\$25.77 million) including payments of: (i) RMB 152,360,000 (\$23.46 million) for the construction of the Project; and (ii) RMB 15,000,000 (\$2.31 million) as payment for partial loan interest accrued during the construction period. Those amounts have been, or will be, paid by Zhongtai to Xi'an TCH according to the following schedule: (a) RMB 50,000,000 (\$7.70 million) was paid within 20 business days after the Transfer Agreement was signed; (b) RMB 30,000,000 (\$4.32 million) was paid within 20 business days after the Project is completed, but no later than July 30, 2016; and (c) RMB 87,360,000 (\$13.45 million) will be paid no later than July 30, 2017. Xuzhou Taifa Special Steel Technology Co., Ltd. ("Xuzhou Taifa") has guaranteed the payments from Zhongtai to Xi'an TCH. The ownership of the Project was conditionally transferred to Zhongtai following the initial payment of RMB 50,000,000 (\$7.70 million) by Zhongtai to Xi'an TCH and the full ownership of the Project will be officially transferred to Zhongtai after it completes all payments pursuant to the Transfer Agreement. As of June 30, 2017, Xi'an TCH had received the first payment of \$7.70 million and the second payment of \$4.32 million. The Company recorded a \$2.82 million loss from this transaction in 2016. As of this report date, the Company has not yet received the remaining payment of RMB 87,360,000 (\$13.45 million), the Company expects to collect this remaining balance during the third quarter of 2017.

On June 22, 2016, Xi'an TCH entered into a Coal Oven Gas Power Generation Project Repurchase Agreement (the "Repurchase Agreement") with Yida. Under the Repurchase Agreement, Xi'an TCH agreed to transfer to Yida all the project assets for RMB 112,000,000 (\$16.89 million) (the "Transfer Price") with Yida's retention of ownership of the Shares. Yida agreed to make the following payments: (i) the outstanding monthly leasing fees for April and May 2016 in total of RMB 6,000,000 (\$0.90 million) to Xi'an TCH within 5 business days from the execution of the Repurchase Agreement; (ii) a payment of RMB 50,000,000 (\$7.54 million) of the Transfer Price to Xi'an TCH within 5 business days from the execution of the Repurchase Agreement; and (iii) a payment of the remaining RMB 62,000,000 (\$9.35 million) of the Transfer Price to Xi'an TCH within 15 business days from the execution of the Repurchase Agreement. Under the Repurchase Agreement, ownership of the project assets will be transferred from Xi'an TCH to Yida within 3 business days after Xi'an TCH receives the full Transfer Price and the outstanding monthly leasing fees. In July 2016, the Company had received the full payment of the Transfer Price and title to the system was transferred at that time. The Company recorded a \$0.42 million loss from this transaction in 2016.

*Reverse Stock Split*

On May 24, 2016, the Company filed a Certificate of Change with the Secretary of State of Nevada with an effective date of May 25, 2016 (the “Effective Date”), at which time the Company effected a 1-for-10 reverse stock split of the Company’s authorized shares of common stock, par value \$0.001 (the “Common Stock”), accompanied by a corresponding decrease in the Company’s issued and outstanding shares of Common Stock (the “Reverse Stock Split”).

The Company rounded up to the next full share of the Company’s Common Stock any fractional shares resulting from the Reverse Stock Split. The Reverse Stock Split was retroactively stated for the periods covered by the financial statements included herein.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of Presentation**

The unaudited financial statements included herein were prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) that are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) were omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited financial statements and footnotes included in the Company’s 2016 audited financial statements included in the Company’s Annual Report on Form 10-K. The results for the six and three months ended June 30, 2017 are not necessarily indicative of the results expected for the full year ending December 31, 2017.

## Basis of Consolidation

The consolidated financial statements (“CFS”) include the accounts of CREG and its subsidiaries, Shanghai Yinghua Financial Leasing Co., Ltd. (“Yinghua”) and Sifang Holdings, its wholly owned subsidiaries, Huahong New Energy Technology Co., Ltd. (“Huahong”) and Shanghai TCH, Shanghai TCH’s wholly-owned subsidiary, Xi’an TCH Energy Tech Co., Ltd. (“Xi’an TCH”) and Xi’an TCH’s subsidiaries, Erdos TCH Energy Saving Development Co., Ltd (“Erdos TCH”), 100% owned by Xi’an TCH (See note 1), Zhonghong, 90% owned by Xi’an TCH, and Zhongxun, 100% owned by Xi’an TCH. Substantially all the Company’s revenues are derived from the operations of Shanghai TCH and its subsidiaries, which represent substantially all the Company’s consolidated assets and liabilities as of June 30, 2017 and December 31, 2016, respectively. All significant inter-company accounts and transactions were eliminated in consolidation.

## Use of Estimates

In preparing these CFS in accordance with US GAAP, management makes estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheets as well as revenues and expenses during the period reported. Actual results may differ from these estimates.

## Revenue Recognition

### *Sales-type Leasing and Related Revenue Recognition*

The Company constructs and leases waste energy recycling power generating projects to its customers. The Company typically transfers ownership of the waste energy recycling power generating projects to its customers at the end of the lease. The investment in these projects is recorded as investment in sales-type leases in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 840, “Leases,” and its various amendments and interpretations. The Company finances construction of waste energy recycling power generating projects. The sales and cost of sales are recognized at the inception of the lease. The investment in sales-type leases consists of the sum of the minimum lease payments receivable less unearned interest income and estimated executory cost. Minimum lease payments are part of the lease agreement between the Company (as the lessor) and the customer (as the lessee). The discount rate implicit in the lease is used to calculate the present value of minimum lease payments. The minimum lease payments consist of the gross lease payments net of executory costs and contingent rentals, if any. Unearned interest income is amortized to income over the lease term to produce a constant periodic rate of return on net investment in the lease. While revenue is recognized at the inception of the lease, the cash flow from the sales-type lease occurs over the course of the lease, which results in interest income and reduction of receivables.

Revenue is recognized net of sales tax.

*Contingent Rental Income*

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

Cash and Equivalents

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

#### Accounts Receivable

As of June 30, 2017, the Company had accounts receivable of \$12,895,607 (from sale of CDQ and a CDQ WHPG system to Zhongtai). As of December 31, 2016, the Company had accounts receivable of \$12,593,340 (from sale of CDQ and a CDQ WHPG system to Zhongtai).

#### Interest Receivable on Sales Type Leases

As of June 30, 2017, the interest receivable on sales type leases was \$7,695,920, mainly from recognized but not yet collected interest income for the Pucheng and Shenqiu systems. As of December 31, 2016, the interest receivable on sales type leases was \$4,621,491.

The Company maintains reserves for potential credit losses on receivables. Management reviews the composition of receivables 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.

#### Property and Equipment

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

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

#### Impairment of Long-lived Assets

In accordance with FASB ASC Topic 360, "*Property, Plant, and Equipment*," the Company reviews its long-lived assets, including property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. If the total expected undiscounted future net cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and carrying amount of the asset. The total undiscounted future net cash flow (total future payment receivable) is less than net investment in sales-type leases for Erdos Phase II, the 2nd system at December 31, 2016; accordingly, the Company recorded an asset impairment loss of \$242,305 for the year ended December 31, 2016. There was no impairment loss for the six and three months ended June 30, 2017.

#### Notes Payable – Banker’s Acceptances

The Company endorses banker’s acceptances that are issued from a bank to vendors as payment for its obligations. Most of the banker’s acceptances have maturity dates of less than six months following their issuance.

#### Cost of Sales

Cost of sales consists primarily of the direct material of the power generating system and expenses incurred directly for project construction for sales-type leasing and sales tax and additions for contingent rental income.

#### Noncontrolling Interests

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

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

#### Fair Value of Financial Instruments

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

FASB ASC Topic 820, "*Fair Value Measurements and Disclosures*," requires disclosure of the fair value ("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 FV because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels of valuation hierarchy are defined as follows:

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

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

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

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

The following are the considerations with respect to disclosures of FV of long-term debt obligations:

As of June 30, 2017, the Company's long-term debt obligations consisted of the Zhonghong entrusted loan of \$49.01 million (Note 12). As of December 31, 2016, the Company's long-term debt obligations consisted of the Zhonghong entrusted loan of \$47.86 million.

FV measurements and approximations for certain financial instruments are based on what a reporting entity would likely have to pay to transfer the financial obligation to an entity with a comparable credit rating. The Company's bank loans and trust loans payable are privately held (i.e., nonpublic) debt; therefore, pricing inputs are not observable. For this reason, the Company classified bank loans and trust loans payable as a Level 3 FV measurement in the valuation hierarchy.

For the Company's long-term bank loans, and Zhonghong entrusted loans noted above, the Company believes the carrying amounts approximate their FV. Based on the Company's understanding of the credit markets, the Company's business is in a sector (energy-saving green) that is supported by the PRC government and the lending bank, the Company believes it could have obtained similar loans on similar terms and interest rates. In addition, in connection with the FV measurement, the Company considered nonperformance risk (including credit risk) relating to the debt obligations, including the following: (i) the Company is considered a low credit risk customer to the lending bank and its creditors; (ii) the Company has a good history of making timely payments and have never defaulted on any loans; and (iii) the Company has a stable and continuous cash inflow from collections from its sales-type lease of energy saving projects.

As of June 30, 2017 and December 31, 2016, the Company did not identify any assets or liabilities that are required to be presented on the balance sheet at FV.



## Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with FASB ASC Topic 718 “*Compensation—Stock Compensation*,” and FASB ASC Topic 505, “*Equity*.” The Company recognizes in its statement of operations FV at the grant date for stock options and other equity-based compensation issued to employees and non-employees.

## Basic and Diluted Earnings per Share

The Company presents net income (loss) per share (“EPS”) in accordance with FASB ASC Topic 260, “*Earning Per Share*.” Accordingly, basic income (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of shares outstanding, without consideration for common stock equivalents. Diluted EPS is computed by dividing the net income by the weighted-average number of common shares outstanding as well as common share equivalents outstanding for the period determined using the treasury-stock method for stock options and warrants and the if-converted method for convertible notes. The Company made an accounting policy election to use the if-converted method for convertible securities that are eligible to receive common stock dividends, if declared. Diluted EPS reflect the potential dilution that could occur based on the exercise of stock options or warrants or conversion of convertible securities using the if-converted method.

The following table presents a reconciliation of basic and diluted EPS for the six and three months ended June 30, 2017 and 2016:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$743,932	\$2,440,952	\$369,511	\$2,347,926
Weighted average shares outstanding – basic	8,310,198	8,310,159	8,310,198	8,310,159
Effect of dilutive securities:				
Options granted	-	-	-	-
Weighted average shares outstanding – diluted	8,310,198	8,310,159	8,310,198	8,310,159
Earnings per share – basic	\$0.09	\$0.29	\$0.04	\$0.28
Earnings per share – diluted	\$0.09	\$0.29	\$0.04	\$0.28

The outstanding stock options were anti-dilutive.

Foreign Currency Translation and Comprehensive Income (Loss)

The Company's functional currency is the Renminbi ("RMB"). For financial reporting purposes, RMB were translated into United States Dollars ("USD" or "\$") as the reporting currency. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Revenues and expenses are translated at the average rate of exchange prevailing during the reporting period. Translation adjustments arising from the use of different exchange rates from period to period are included as a component of stockholders' equity as "Accumulated other comprehensive income." Gains and losses resulting from foreign currency transactions are included in income. There was no significant fluctuation in the exchange rate for the conversion of RMB to USD after the balance sheet date.

The Company follows FASB ASC Topic 220, "*Comprehensive Income*." Comprehensive income is comprised of net income and all changes to the statements of stockholders' equity, except those due to investments by stockholders, changes in paid-in capital and distributions to stockholders.

## 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. FASB ASC Topic 280 has no effect on the Company’s CFS as substantially all of the Company’s operations are conducted in one industry segment. All of the Company’s assets are located in the PRC.

## New Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update (“ASU”) 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 2016-02 requires 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 CFS.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 clarifies the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. This ASU is effective for public business entities for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted. The Company is currently assessing the potential impact of ASU 2016-15 on its CFS.

In October 2016, the FASB issued ASU No. 2016-16—Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This ASU improves the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. For public business entities, the amendments in this update are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. Early adoption is permitted. The Company does not anticipate that the adoption of this ASU will have a significant impact on its CFS.

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 CFS.

## Reclassification

In November 2015, the FASB issued ASU No. 2015-17 on the balance sheet classification of deferred taxes, which would require that deferred tax assets and liabilities be classified as non-current in the balance sheet. Current GAAP requires the presentation of deferred tax assets and liabilities as either current or non-current in the balance sheet. This ASU is effective for annual reporting periods beginning after December 15, 2016, including interim reporting periods within those annual reporting periods. Earlier adoption is permitted. The guidance may be applied either prospectively or retrospectively. The Company adopted this ASU as of December 31, 2016 on a retrospective basis and reclassified current deferred tax liability (net) to the noncurrent deferred tax liability (net) in the consolidated balance sheet as of December 31, 2016. The reclassification had no effect on reported revenues, operating income, or cash flows for the periods presented.

**3. RESTRICTED CASH**

Restricted cash is held by the banks as collateral to issue bank acceptances and bank loans. The Company endorses bank acceptances to vendors as payment of its obligations. Most of the bank acceptances have maturities of less than six months. As of June 30, 2017 and December 31, 2016, the Company had restricted cash of \$0.

**4. INVESTMENT IN SALES-TYPE LEASES, NET**

Under sales-type leases, Xi'an TCH leases the following systems: (i) BMPG systems to Pucheng Phase I and II (15 and 11 year terms, respectively); (ii) BMPG systems to Shenqiu Phase I (11-year term); and (iii) Shenqiu Phase II (9.5-year term). In addition, as of June 30, 2017, Erdos TCH leased power and steam generating systems from waste heat from metal refining to Erdos (five systems) for a term of twenty years. The components of the net investment in sales-type leases as of June 30, 2017 and December 31, 2016 are as follows:

	2017	2016
Total future minimum lease payments receivable	\$220,128,619	\$217,470,913
Less: executory cost	(66,859,949 )	(66,444,519 )
Less: unearned interest income	(32,395,946 )	(35,312,473 )
Less: realized interest income but not yet received	(7,695,920 )	(4,621,490 )
Investment in sales-type leases, net	113,176,804	111,092,431
Current portion	12,552,397	9,385,453
Noncurrent portion	\$100,624,407	\$101,706,978

As of June 30, 2017, the future minimum rentals to be received on non-cancelable sales-type leases by years are as follows:

2018	\$34,528,557
2019	19,389,739
2020	19,389,739
2021	20,939,061
2022	21,942,083
Thereafter	103,939,440
Total	\$220,128,619

**5. PREPAID EXPENSES**

Prepaid expenses mainly consisted of prepayment for office rental and decorations, taxes, and consulting fees for the Company's HYREF fund completed in July 2013. Before the HYREF Fund released the money to Zhonghong, Xi'an TCH paid 2% of the funds raised for Zhonghong, i.e. RMB 9.2 million (\$1.5 million) to the Fund Management Company as a consulting fee and it shall pay such 2% on the amount of funds actually contributed as an annual management fee on every 365-day anniversary thereafter until Zhonghong fully repays the loan, and the HYREF Fund no longer has an ownership interest in Zhonghong. The Company had \$0.10 million and \$0.65 million prepaid consulting expense as of June 30, 2017 and December 31, 2016, respectively. The Company had \$17,581 and \$32,050 prepaid tax as of June 30, 2017 and December 31, 2016.

## **6. OTHER RECEIVABLES**

As of June 30, 2017, other receivables mainly consisted of (i) advances to third parties of \$0.95 million, bearing no interest, payable upon demand; (ii) maintenance cost and tax receivable of \$1.39 million; and (iii) advances to employees of \$6,843, bearing no interest, payable upon demand. As of December 31, 2016, other receivables mainly consisted of an advance to a third party of \$0.53 million, bearing no interest, payable upon demand; and advances to employees of \$0.02 million, bearing no interest, payable upon demand.

## 7. LONG TERM INVESTMENT

On June 25, 2013, Xi'an TCH with HongyuanHuifu Venture Capital Co. Ltd ("HongyuanHuifu") jointly established Hongyuan Recycling Energy Investment Management Beijing Co., Ltd (the "Fund Management Company") with registered capital of RMB 10 million (\$1.6 million), to manage a fund that will be used for financing CDQ WHPG projects. Xi'an TCH made an initial capital contribution of RMB 4 million (\$0.65 million) and has a 40% ownership interest in the Fund Management Company. Voting rights and dividend rights are allocated between HongyuanHuifu and Xi'an TCH at 80% and 20%, respectively. The Company accounted for this investment using the equity method. The Company recorded \$87,331 and \$47,580 equity based investment income during the six and three months ended June 30, 2017. The Company recorded \$105,975 and \$52,956 equity based investment income during the six and three months ended June 30, 2016. Xi'an TCH paid a \$1.6 million one-time commission (recorded as other expense) to the Fund Management Company during 2013 for initiating and completing the Fund financing for the Company.

On July 18, 2013, the HYREF Fund was established as a limited liability partnership in Beijing. Pursuant to the Partnership Agreement, the HYREF Fund has a general partner, the Fund Management Company, which made an initial capital contribution of RMB 5 million (\$0.83 million) to the HYREF Fund. The HYREF Fund has three limited partners: (1) China Orient Asset Management Co., Ltd., which made an initial capital contribution of RMB 280 million (\$46.67 million) and is a preferred limited partner, (2) HongyuanHuifu, which made an initial capital contribution of RMB 100 million (\$16.67 million) and is an ordinary limited partner and (3) the Company's wholly-owned subsidiary, Xian TCH, which made an initial capital contribution of RMB 75 million (\$10.81 million) and is a secondary limited partner. The term of the HYREF Fund's partnership is six years from the date of its establishment, July 18, 2013. The current term for (x) the preferred limited partner is four years from the date of its contribution and (y) the ordinary limited partner is four years from the date of its contribution. Unless otherwise approved by the general partner (the Fund Management Company), upon the expiration of their respective terms, each partner shall exit from the partnership automatically. The total size of the HYREF Fund is RMB 460 million (\$75.0 million), and the purpose of the HYREF Fund is to invest in Zhonghong for constructing 3 new CDQ WHPG projects. Xi'an TCH owns 16.3% of the HYREF Fund. The Company accounted for this investment using the cost method. The Company netted off the investment of RMB 75 million (\$10.81 million) by Xi'an TCH with the entrusted loan payable of the HYREF Fund.

## 8. CONSTRUCTION IN PROGRESS

Construction in progress was for constructing power generation systems. As of June 30, 2017 and December 31, 2016, the Company's construction in progress included:

	2017	2016
Xuzhou Huayu	\$24,090,597	\$23,525,925

Xuzhou Tian'an	34,849,365	32,471,977
Boxing County Chengli	31,227,232	30,495,280
Total	\$90,167,194	\$86,493,182

As of June 30, 2017, the Company was committed to pay an additional (1) \$11.81 million for the Xuzhou Huayu project, and (2) \$4.10 million for the Xuzhou Tian'an project. The Boxing County Chengli project finished construction, but is waiting for government approval before beginning operations.

## 9. TAXES PAYABLE

Taxes payable consisted of the following as of June 30, 2017 and December 31, 2016:

	2017	2016
Income	\$306,088	\$773,397
VAT	755,542	366,230
Other	117,402	63,050
Total	\$1,179,032	\$1,202,677



**10. ACCRUED LIABILITIES AND OTHER PAYABLES**

Accrued liabilities and other payables consisted of the following as of June 30, 2017 and December 31, 2016:

	<b>2017</b>	<b>2016</b>
Employee training, labor union expenditure and social insurance payable	\$778,264	\$760,021
Consulting, auditing, and legal expenses	476,725	468,393
Accrued payroll and welfare	285,452	322,605
Accrued interest	-	1,569
Other	33,019	43,992
Total	\$1,573,460	\$1,596,580

**11. DEFERRED TAX LIABILITY, NET**

Deferred tax asset resulted from accrued employee social insurance that can be deducted for tax purposes in the future, and the difference between tax and accounting basis of cost of fixed assets which was capitalized for tax purposes and expensed as part of cost of systems in accordance with US GAAP. Deferred tax liability arose from the difference between tax and accounting basis of net investment in sales-type leases.

As of June 30, 2017 and December 31, 2016, deferred tax liability consisted of the following:

	2017	2016
Deferred tax asset — current (accrual of employee social insurance)	\$172,012	\$167,980
Deferred tax liability — current (net investment in sales-type leases)	(1,746,046 )	(1,586,058 )
Deferred tax liability, net of current deferred tax asset	\$(1,574,034 )	\$(1,418,078 )
Deferred tax asset — noncurrent (depreciation of fixed assets)	\$17,496,549	\$17,943,843
Deferred tax liability — noncurrent (net investment in sales-type leases)	(25,156,102)	(25,426,744)
Deferred tax liability, net of noncurrent deferred tax asset	\$(7,659,553 )	\$(7,482,901 )
Total Deferred tax liability, noncurrent per ASU 2015-17	\$9,233,587	\$8,900,979

**12. LOANS PAYABLE**

*Entrusted Loan Payable*

The HYREF Fund (Beijing Hongyuan Recycling Energy Investment Center, LLP) established in July 2013 with total fund size of RMB 460 million (\$75.0 million) invests in Xi'an Zhonghong for Zhonghong's three new CDQ WHPG projects. The HYREF Fund invested RMB 3 million (\$0.5 million) as an equity investment and RMB 457 million (\$74.5 million) as a debt investment in Xi'an Zhonghong; in return for such investments, the HYREF Fund will receive interest from Zhonghong for the HYREF Fund's debt investment. The RMB 457 million (\$74.5 million) was released to Zhonghong through an entrusted bank, which is also the supervising bank for the use of the loan. The loan was deposited in a bank account at the Supervising Bank (the Industrial Bank Xi'an Branch) and is jointly supervised by Zhonghong and the Fund Management Company. Project spending shall be verified by the Fund Management Company to confirm that it is in accordance with the project schedule before the funds are released. All the operating accounts of Zhonghong have been opened with the branches of the Supervising Bank and the Supervising Bank has the right to monitor all bank accounts opened by Zhonghong. The entrusted bank will charge 0.1% of loan amount as service fee and will not take any lending risk. The loan was collateralized by the accounts receivable and the fixed assets of Shenqiu Phase I and II power generation systems, the accounts receivable and fixed assets of Zhonghong's three CDQ WHPG systems, and a 27 million RMB capital contribution made by Xi'an TCH. Repayment of the loan (principal and interest) was also jointly and severally guaranteed by Xi'an TCH and the Chairman and CEO of the Company. In the fourth quarter of 2015, three power stations of Erdos TCH were pledged to Industrial Bank as an additional guarantee for the loan lent to Zhonghong's three CDQ WHPG systems. In 2016, two additional power stations of Erdos TCH and Pucheng Phase I and II systems were pledged to Industrial Bank as an additional guarantee along with Xi'an TCH's equity in Zhonghong.

The loan agreement provides that Zhonghong shall also maintain a certain capital level in its account with the Supervising Bank to make sure it has sufficient funds to make interest payments when they are due:

During the first three years from the first release of the loan, the balance in its account shall be no less than RMB 7.14 million (\$1.19 million) on the 20th day of the second month of each quarter and no less than RMB 14.28 million (\$2.38 million) on the 14th day of the last month of each quarter;

During the fourth year from the first release of the loan, the balance in its account shall be no less than RMB 1.92 million (\$0.32 million) on the 20th day of the second month of each quarter and no less than RMB 3.85 million (\$0.64 million) on the 14th day of the last month of each quarter; and

During the fifth year from the first release of the loan, the balance in its account shall be no less than RMB 96,300 (\$16,050) on the 20th day of the second month of each quarter and no less than RMB 192,500 (\$32,080) on the 14th day of the last month of each quarter.

The term of this loan is for 60 months from July 31, 2013 to July 30, 2018. On August 6, 2016, Zhonghong was to repay principal of RMB 280 million (\$42.22 million); on August 6, 2017, Zhonghong shall repay principal of RMB 100 million (\$16.27 million) and on July 30, 2018, Zhonghong shall repay the remainder of RMB 77 million (\$12.52 million). The interest rate is 12.5%. During the term, Zhonghong shall maintain a minimal funding level and capital level in its designated account with the Supervising Bank to make sure it has sufficient funds to make principal payments when they are due. Notwithstanding the requirement, there is a verbal agreement from the HYREF Fund that for the purpose of the efficient utilization of working capital, Zhonghong does not have to maintain a minimum funding level in its designated account with the Supervising Bank. As of June 30, 2017, the entrusted loan payable had an outstanding balance of \$60.08 million, of which, \$11.07 million was from the investment of Xi'an TCH; accordingly, the Company netted the loan payable of \$11.07 million with the long-term investment to the HYREF Fund made by Xi'an TCH. For the six and three months ended June 30, 2017, the Company recorded interest expense of \$2.15 million and \$1.08 million on this loan, respectively; and capitalized \$1.58 million and \$0.79 million interest to construction in progress, respectively. For the six and three months ended June 30, 2016, the Company recorded interest expense of \$2.36 million and \$1.54 million on this loan, respectively; and capitalized \$2.06 million and \$0.67 million interest to construction in progress, respectively. The Company had fully paid RMB 50 million (\$7.54 million) of the RMB 280 million (\$42.22 million), and on August 5, 2016, the Company entered a supplemental agreement with the lender to extend the due date of the remaining RMB 230 million (\$34.68 million) of the original RMB 280 million (\$45.54 million) to August 6, 2017. During the six months ended June 30, 2017, the Company negotiated with the lender again for further extending the remaining loan balance of RMB 230 million (\$34.68 million) and RMB 100 million (\$16.27 million), and the lender has agreed to extend the RMB 330 million (\$50.95 million) loan for another two years until August 2019 with an adjusted annual interest rate of 9%. The related extension documents are currently going through the lender's internal approval procedure.

Due to the slow progress of the construction of the three CDQ WHPG projects, the Company has applied for a lower interest rate from the lender since January of 2017, and is currently waiting for the lender's decision. The Company has temporarily stopped making interest payments during the waiting period. As of June 30, 2017, the interest payable for

this loan was \$4.00 million.

*Bank Loan – Bank of Xi’an*

On June 26, 2015, Xi’an TCH entered into a loan agreement with Bank of Xi’an, whereby Bank of Xi’an loaned \$6.29 million (RMB 40 million) to Xi’an TCH for one year due on June 25, 2016. The monthly interest on the loan was 0.595%. Under the terms of the loan, Xi’an TCH was required to make monthly interest payments and the principal was to be repaid at maturity. The loan was guaranteed by a third party guarantee company and the Chairman and CEO of the Company. The Company paid a third party \$149,341 (RMB 950,000) as a re-guarantee service fee. As of December 31, 2016, this loan was paid in full.

*Bank Loan – Bank of Chongqing*

On April 11, 2014, Xi’an TCH entered into a loan agreement with Bank of Chongqing - Xi’an Branch, whereby Bank of Chongqing loaned \$8.13 million (RMB 50 million) to Xi’an TCH for three years with maturity on April 10, 2017. The interest of the loan is 9.225%. Under the terms of the loan, Xi’an TCH was to make monthly interest payments and to make a principal payment of \$0.81 million (RMB 5 million) on the 24<sup>th</sup> month after receiving the loan and of the remaining \$7.32 million (RMB 45 million) on the loan maturity date. The loan was guaranteed by a third party guarantee company and the Chairman and CEO of the Company. The Company paid a third party \$155,280 (RMB 950,000) as a re-guarantee service fee. In addition, Xi’an TCH pledged its collection right for Tangshan Rongfeng and Xuzhou Zhongtai projects to Bank of Chongqing after the two projects were completed and put into operation, to ensure the repayment of loan. This loan was paid in full on April 10, 2017.

*Summary*

As of June 30, 2017, the future minimum repayment of all the loans including the entrusted loan to be made by years is as follows:

2018	\$48,712,801
2019	295,229
Total	\$49,008,030

**13. REFUNDABLE DEPOSIT FROM CUSTOMERS FOR SYSTEMS LEASING**

The refundable deposit was mainly for Pucheng, Shenqiu and Yida systems. As of June 30, 2017 and December 31, 2016, the balance of refundable deposit from customers for systems leasing was \$1,048,063 for Pucheng and Shengqiu systems, and \$1,023,497 for Pucheng, Shenqiu and Yida systems, respectively.

**14. RELATED PARTY TRANSACTIONS**

As of June 30, 2017, the Company had \$41,775 in advances from the Company's management, which bear no interest, and are payable upon demand.

During the six and three months ended June 30, 2017, the Company recognized RMB 13.47 million (\$1.96 million) and RMB 6.67 million (\$0.97 million), respectively, interest income for the sales-type lease of Pucheng BMPG systems from Pucheng Xin Heng Yuan Biomass Power Generation Corporation, whose major stockholder became a stockholder of the Company through the issuance of the Company's common stock to this stockholder in consideration for the transfer of the old system to the Company for BMPG system transformation.

Also during the year ended December 31, 2016, prior to repurchase date of June 22, 2016, the Company recognized RMB 13.83 million (\$2.09 million) interest income for the sales-type lease of Yida WGPG system from Qitaihe City Boli Yida Coal Selection Co., Ltd., whose major stockholder became a stockholder of the Company through the issuance of the Company's common stock to this stockholder in consideration for the transfer of the old system to the

Company for WGPG system transformation.

## 15. NONCONTROLLING INTEREST

On July 15, 2013, Xi'an TCH and HYREF Fund jointly established Xi'an Zhonghong New Energy Technology ("Zhonghong") with registered capital of RMB 30 million (\$4.88 million), to manage new projects. Xi'an TCH paid RMB 27 million (\$4.37 million). Xi'an TCH owns 90% of Zhonghong while HYREF Fund owns 10% of Zhonghong as non-controlling interest of Zhonghong.

In addition, the HYREF Fund was 16.3% owned by Xi'an TCH and 1.1% owned by the Fund Management Company, and the Fund Management Company was 40% owned by Xi'an TCH as described in Note 7, which resulted in an additional indirect ownership of Xi'an TCH in Zhonghong of 1.7%; accordingly, the ultimate non-controlling interest (HYREF Fund) in Zhonghong became 8.3%. During the six months ended June 30, 2017 and 2016, the Company had losses of \$178,255 and \$147,205 that were attributable to the noncontrolling interest, respectively. During the three months ended June 30, 2017 and 2016, the Company had losses of \$89,832 and \$95,925 that were attributable to noncontrolling interest, respectively.

## 16. INCOME TAX

The Company's Chinese subsidiaries 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 Chinese tax law, the tax treatment of finance and sales-type leases is similar to US GAAP. However, the local tax bureau continues to treat CREG sales-type leases as operating leases. Accordingly, the Company recorded deferred income taxes.

The Company's subsidiaries generate all of their income from their PRC operations. Yinghua and Shanghai TCH's effective income tax rate for 2017 and 2016 was 25%. During 2013, Xi'an TCH was re-approved for high tech enterprise status and enjoyed 15% preferential income tax rate for three years effective January 1, 2013 through December 31, 2015, and is subject to 25% income tax rate in 2017 and 2016 due to the renewal of preferential income tax rate was not approved by the tax authority. Huahong, Zhonghong and Erdos TCH's effective income tax rate for 2017 and 2016 was 25%. Yinghua, Shanghai TCH, Xi'an TCH, Huahong, Zhonghong and Erdos TCH file separate income tax returns.

There is no income tax for companies domiciled in the Cayman Islands. Accordingly, the Company's CFS do not present any income tax provisions related to Cayman Islands tax jurisdiction, where Sifang Holding is domiciled.

The US parent company, China Recycling Energy Corporation, is taxed in the US and, as of June 30, 2017, had net operating loss ("NOL") carry forwards for income taxes of \$14.15 million, which may be available to reduce future years' taxable income as NOLs can be carried forward up to 20 years from the year the loss is incurred. Our management believes the realization of benefits from these losses may be uncertain due to the US parent company's continuing operating losses. Accordingly, a 100% deferred tax asset valuation allowance was provided.

The following table reconciles the US statutory rates to the Company's effective tax rate for the six and three months ended June 30, 2017 and 2016, respectively:

	Six Months		Three Months	
	2017	2016	2017	2016
U.S. statutory rates	34.0%	34.0 %	34.0 %	34.0 %
Tax rate difference – current provision	(9.0)%	(10.6)%	(10.5)%	(9.4)%
Permanent difference	0.1 %	-	0.2 %	-
Other	(7.0)%	0.2 %	(9.1)%	1.5 %
Valuation allowance on PRC NOL	39.8%	(106.0)%	42.0 %	(142.0)%

Valuation allowance on US NOL	0.1 %	8.8 %	0.1 %	5.1 %
Tax per financial statements	58.0%	(73.6 )%	56.7 %	(110.8)%

The provision for income taxes expense for the six and three months ended June 30, 2017 and 2016 consisted of the following:

	Six Months		Three Months	
	2017	2016	2017	2016
Income tax expense – current	\$664,651	\$905,908	\$325,428	\$549,409
Income tax expense (benefit) – deferred	117,315	(1,878,676)	40,235	(1,732,948)
Total income tax expense (benefit)	\$781,966	\$(972,768 )	\$365,663	\$(1,183,539)

## 17. STOCK-BASED COMPENSATION PLAN

### *Options to Employees*

On June 19, 2015, the stockholders of the Company approved the China Recycling Energy Corporation Omnibus Equity Plan (the “Plan”) at its annual meeting. The total shares of common stock authorized for issuance during the term of the Plan is 12,462,605 shares (prior to the 10:1 Reverse Stock Split). The Plan was effective immediately upon the adoption by our Board of Directors on April 24, 2015, subject to stockholder approval, and will terminate on the earliest to occur of (i) the 10th anniversary of the Plan’s effective date, or (ii) the date on which all shares available for issuance under the Plan shall have been issued as fully-vested shares.



On April 27, 2017, the Board approved the grant to the Company's CFO of an option to purchase 5,000 shares of the Company's common stock at an exercise price of \$1.61 per share, with a term of 10 years. The option vested immediately upon the grant.

The FV of the stock option granted is estimated on the date of the grant using the Black-Scholes option pricing model ("BSOPM"). The BSOPM 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 United States 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 as no options have been exercised in the Plan to date. The FV of the option granted to employees is recognized as compensation expense over the vesting period of the stock option award. The FV of the options was calculated using the following assumptions, estimated life of ten years, volatility of 124%, risk free interest rate of 2.30%, and dividend yield of 0%. The FV of 5,000 stock options were \$7,647 at the grant date.

#### *Options to Independent Directors*

On March 31, 2015, the Board appointed Mr. Cangsang Huang as a member of the Company's Board of Directors to fill a vacancy. In connection with the appointment, the Board authorized the Company to provide Mr. Huang with (i) compensation of \$2,000 per month and (ii) the grant of an option to purchase 40,000 shares of the Company's Common Stock, par value \$0.001, at an exercise price of \$1.02 per share (prior to the 10:1 Reverse Stock Split effective May 25, 2016), which was equal to the closing price per share of the Company's Common Stock on March 31, 2015. Such options were only valid and exercisable upon stockholder approval. The options to Mr. Huang were not voted upon at the Company's annual stockholder's meeting on June 19, 2015 and were cancelled automatically. However, the Company's Plan adopted by the Board on April 24, 2015 for providing equity awards to employees, directors and consultants was approved at the annual stockholder's meeting; accordingly, the Compensation Committee of the Board of Directors approved a grant of 40,000 options (prior to the 10:1 Reverse Stock Split) to Mr. Huang at an exercise price of \$1.02 per share under the Plan, which vested immediately on the date of grant, which was on October 10, 2015. The options may be exercised within five years of the date of the grant. The FV of the options was calculated using the following assumptions, estimated life of five years, volatility of 82%, risk free interest rate of 1.37%, and dividend yield of 0%. The FV of 40,000 stock options were \$26,528 at the grant date.

The Company recorded \$7,647 compensation expense for stock options to employees during the six and three months ended June 30, 2017 and \$0 during the six and three months ended 2016.

The following table summarizes option activity with respect to employees and independent directors, the number of options reflects the 10:1 Reverse Stock Split effective May 25, 2016:

	<b>Number of Shares</b>	<b>Average Exercise Price per Share</b>	<b>Weighted Average Remaining Contractual Term in Years</b>
Outstanding at January 1, 2016	4,000	\$ 10.2	4.77
Exercisable at January 1, 2016	4,000	10.2	4.77
Granted	-	-	-
Exercised	-	-	-
Forfeited	-	-	-
Outstanding at December 31, 2016	4,000	10.2	3.77
Exercisable at December 31, 2016	4,000	10.2	3.77
Granted	5,000	-	-
Exercised	-	-	-
Forfeited	-	-	-
Outstanding at June 30, 2017	9,000	5.4	6.91
Exercisable at June 30, 2017	9,000	\$ 5.4	6.91

## 18. 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 and foreign currency exchange. The Company's results may be adversely affected by changes in governmental 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 are denominated in RMB and all of the Company's assets and liabilities are also denominated in RMB. The RMB is not freely convertible into foreign currencies under the current 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 make the remittance.

The Company sells electricity to its customers and receives commercial notes (bank acceptance) from them in lieu of payments for accounts receivable. The Company discounts the commercial notes with the bank or endorses 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 six (6) months. As of June 30, 2017, the Company had outstanding notes receivable of \$797,119, and endorsed notes receivable to vendors of \$1.63 million; at December 31, 2016, the Company had outstanding and endorsed notes receivable of \$0.

## 19. COMMITMENTS

### *Lease Commitment*

On March 4, 2014, Xi'an TCH's office lease expired and Xi'an TCH renewed this lease for two years; the monthly rental payment is \$20,140. The lease for the office in Xi'an was renewed for two years starting on March 5, 2016 with a monthly rental payment of \$21,804 but payable quarterly in advance. For the six months ended June 30, 2017 and 2016, the rental expense of Xi'an TCH was \$118,413 and \$126,384, respectively. For the three months ended June 30, 2017 and 2016, the rental expense of Xi'an TCH was \$59,348 and \$69,658, respectively.

Future minimum annual rental payments required under operating leases as of June 30, 2017 were as below (by year):

2018 \$189,124  
Total \$189,124

*Construction Commitment*

Refer to Note 1 for additional details related to lease commitments with Chengli, Tianyu (and its subsidiaries Xuzhou Tian'an and Xuzhou Huayu), and Zhongtai and Note 8 for commitments on construction in progress.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Note Regarding Forward-Looking Statements**

*This quarterly report on Form 10-Q and other reports filed by the Company from time to time with the SEC (collectively the "Filings") contain or may contain forward-looking statements and information that are based upon beliefs of, and information currently available to, Company's management as well as estimates and assumptions made by Company's management. Readers are cautioned not to place undue reliance on these forward-looking statements, which are only predictions and speak only as of the date hereof. When used in the filings, the words "may", "will", "should", "would", "anticipate", "believe", "estimate", "expect", "future", "intend", "plan", or the negative of these terms and similar expressions as they relate to Company or Company's management identify forward-looking statements. Such statements reflect the current view of Company with respect to future events and are subject to risks, uncertainties, assumptions, and other factors (including the statements in the section "results of operations" below), and any businesses that Company may acquire. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended, or planned. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those listed under the heading "Risk Factors" and those listed in our Annual Report on Form 10-K for the year ended December 31, 2016 (the "2016 Form 10-K"). The following discussion should be read in conjunction with our Financial Statements and related Notes thereto included elsewhere in this report and in our 2016 Form 10-K.*

*Although the Company believes the expectations reflected in the forward-looking statements are based on reasonable assumptions, the Company cannot guarantee future results, levels of activity, performance, or achievements. Except as required by applicable law, including the securities laws of the United States, the Company does not intend to update any of the forward-looking statements to conform these statements to actual results. Readers are urged to carefully review and consider the various disclosures made throughout the entirety of this report, which attempts to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations, and prospects.*

*Our financial statements are prepared in US Dollars and in accordance with accounting principles generally accepted in the United States. See "Foreign Currency Translation and Comprehensive Income (Loss)" below for information concerning the exchange rates at which Renminbi ("RMB") were translated into US Dollars ("USD") at various pertinent dates and for pertinent periods.*

### **OVERVIEW OF BUSINESS BACKGROUND**

China Recycling Energy Corporation (the “Company” or “CREG”) was incorporated on May 8, 1980 as Boulder Brewing Company under the laws of the State of Colorado. On September 6, 2001, the Company changed its state of incorporation to Nevada. In 2004, the Company changed its name from Boulder Brewing Company to China Digital Wireless, Inc. and on March 8, 2007, the Company again changed its name from China Digital Wireless, Inc. to its current name, China Recycling Energy Corporation. The Company, through its subsidiaries, sells and leases energy saving systems and equipment to its customers in the People’s Republic of China (“PRC”). Typically, the Company transfers ownership of the waste energy recycling power generating projects to its customers at the end of each sales-type lease and provides financing to its customers for the cost of the projects as described below.

### *Our Subsidiaries*

Our business is primarily conducted through our wholly-owned subsidiaries, Sifang Holdings Co., Ltd. (“Sifeng”) and Shanghai Yinghua Financial Leasing Co., Ltd (“Yinghua”); Sifeng’s wholly-owned subsidiaries, Huahong New Energy Technology Co., Ltd. (“Huahong”) and Shanghai TCH; Shanghai TCH’s wholly-owned subsidiary, Xi’an TCH Energy Technology Company, Ltd (“Xi’an TCH”), Xi’an TCH’s wholly-owned subsidiaries, Erdos TCH Energy Saving Development Co., Ltd (“Erdos TCH”) and Zhongxun Energy Investment (Beijing) Co., Ltd (“Zhongxun”); and Xi’an TCH’s 90% owned subsidiary, Xi’an Zhonghong New Energy Technology Co., Ltd. (“Zhonghong”). Zhonghong is engaged to provide energy saving solutions and services, including constructing, selling and leasing energy saving systems and equipment to customers, project investment, investment management, economic information consulting, technical services, financial leasing, purchase of financial leasing assets, disposal and repair of financial leasing assets, consulting and ensuring of financial leasing transactions.

The Company's current organizational chart is as follows:

## **CREG Legal**

### **Structure**

#### *Shanghai TCH and its Subsidiaries*

Shanghai TCH was established as a foreign investment enterprise in Shanghai under the laws of the PRC on May 25, 2004 and has a registered capital of \$29.80 million. Xi'an TCH was incorporated in Xi'an, Shaanxi Province under the laws of the PRC on November 8, 2007. In February 2009, Huahong was incorporated in Xi'an, Shaanxi province. Erdos TCH was incorporated in April 2009 in Erdos, Inner Mongolia Autonomous Region. On July 19, 2013, Xi'an TCH formed Xi'an Zhonghong New Energy Technology Co., Ltd ("Zhonghong"). Xi'an TCH owns 90% of Zhonghong, which provides energy saving solutions and services, including constructing, selling and leasing energy saving systems and equipment to customers.

As of June 30, 2017, Shanghai TCH, through its subsidiaries, had sales or sales-type leases with the following parties: (i) Erdos (for five recycling waste heat power generating systems); (ii) Pucheng (for two biomass power generation ("BMPG") systems); and (iii) Shenqiu (for two BMPG systems).

#### *The Fund Management Company and the HYREF Fund*

On June 25, 2013, Xi'an TCH and Hongyuan Huifu Venture Capital Co. Ltd ("Hongyuan Huifu") jointly established Hongyuan Recycling Energy Investment Management Beijing Co., Ltd (the "Fund Management Company") with registered capital of RMB 10 million (\$1.45 million). Xi'an TCH made an initial capital contribution of RMB 4 million (\$650,000) and has a 40% ownership interest in the Fund Management Company. With respect to the Fund Management Company, voting rights and dividend rights are allocated 80% and 20% between Hongyuan Huifu and Xi'an TCH, respectively.

The Fund Management Company is the general partner of Beijing Hongyuan Recycling Energy Investment Center, LLP (the “HYREF Fund”), a limited liability partnership established July 18, 2013 in Beijing. The Fund Management Company made an initial capital contribution of RMB 5 million (\$830,000) to the HYREF Fund. An initial amount of RMB 460 million (\$75 million) was fully subscribed by all partners for the HYREF Fund. The HYREF Fund has three limited partners: (1) China Orient Asset Management Co., Ltd., which made an initial capital contribution of RMB 280 million (\$46.67 million) to the HYREF Fund and is a preferred limited partner; (2) Hongyuan Huifu, which made an initial capital contribution of RMB 100 million (\$16.67 million) to the HYREF Fund and is an ordinary limited partner; and (3) the Company’s wholly-owned subsidiary, Xi’an TCH, which made an initial capital contribution of RMB 75 million (\$12.5 million) to the HYREF Fund and is a secondary limited partner. The term of the HYREF Fund’s partnership is six years from the date of its establishment, expiring on July 18, 2019. The current term is four years from the date of contribution for the preferred limited partner, and four years from the date of contribution for the ordinary limited partner. The size of the HYREF Fund is RMB 460 million (\$75 million). The HYREF Fund was formed for the purpose of investing in Xi’an Zhonghong New Energy Technology Co., Ltd., a 90% owned subsidiary of Xi’an TCH, for the construction of two coke dry quenching (“CDQ”) waste heat power generation (“WHPG”) stations with Jiangsu Tianyu Energy and Chemical Group Co., Ltd. (“Tianyu”) and one CDQ WHPG station with Boxing County Chengli Gas Supply Co., Ltd. (“Chengli”).

#### *Erdos TCH – Joint Venture*

On April 14, 2009, the Company formed Erdos TCH as a joint venture (the “JV” or “Erdos TCH”) with Erdos Metallurgy Co., Ltd. (“Erdos”) to recycle waste heat from Erdos’ metal refining plants to generate power and steam to be sold back to Erdos. The JV has a term of 20 years with a total investment for the project estimated at \$79 million (RMB 500 million) and an initial investment of \$17.55 million (RMB 120 million). Erdos contributed 7% of the total investment for the project, and Xi’an TCH contributed 93%. According to Xi’an TCH and Erdos’ agreement on profit distribution, Xi’an TCH and Erdos will receive 80% and 20%, respectively, of the profit from the JV until Xi’an TCH receives the complete return of its investment. Xi’an TCH and Erdos will then receive 60% and 40%, respectively, of the profit from the JV. On June 15, 2013, Xi’an TCH and Erdos entered into a share transfer agreement, pursuant to which Erdos transferred and sold its 7% ownership interest in the JV to Xi’an TCH for \$1.29 million (RMB 8 million), plus certain accumulated profits as described below. Xi’an TCH paid the \$1.29 million in July 2013 and, as a result, became the sole stockholder of Erdos TCH. In addition, Xi’an TCH is required to pay Erdos accumulated profits from inception up to June 30, 2013 in accordance with the supplementary agreement entered on August 6, 2013. In August 2013, Xi’an TCH paid 20% of the accumulated profit (calculated under PRC GAAP) of \$226,000 to Erdos. Erdos TCH currently has two power generation systems in Phase I with a total of 18 MW power capacity, and three power generation systems in Phase II with a total of 27 MW power capacity.

With the current economic conditions in China, the government has limited and reduced over capacity and production in the iron and steel industry, which has resulted in a sharp decrease of Erdos Metallurgy Co., Ltd.’s production of ferrosilicon, its revenue and cash flows, and has made it difficult for Erdos to make the monthly minimum lease payment.



After considering the challenging economic conditions facing Erdos, and in order to maintain the long-term cooperative relationship between the parties, which we believe will continue to produce long-term benefits, on April 28, 2016, Erdos TCH and Erdos entered a supplemental agreement, effective May 1, 2016. Under the supplemental agreement, Erdos TCH cancelled monthly minimum lease payments from Erdos, and agreed to charge Erdos based on actual electricity sold at RMB 0.30 / KWH, which such price will be adjusted annually based on prevailing market conditions.

*Shenqiu Yuneng Biomass Power Generation Projects*

On May 25, 2011, Xi'an TCH entered into a Letter of Intent with Shenqiu YuNeng Thermal Power Co., Ltd. ("Shenqiu") to reconstruct and transform a Thermal Power Generation System owned by Shenqiu into a 75T/H BMPG System for \$3.57 million (RMB 22.5 million). The project commenced in June 2011 and was completed in the third quarter of 2011. On September 28, 2011, Xi'an TCH entered into a Biomass Power Generation Asset Transfer Agreement with Shenqiu (the "Shenqiu Transfer Agreement"). Pursuant to the Shenqiu Transfer Agreement, Shenqiu sold Xi'an TCH a set of 12 MW BMPG systems (after Xi'an TCH converted the system for BMPG purposes). As consideration for the BMPG systems, Xi'an TCH paid Shenqiu \$10.94 million (RMB 70 million) in cash in three installments within six months upon the transfer of ownership of the systems. By the end of 2012, all of the consideration was paid. On September 28, 2011, Xi'an TCH and Shenqiu also entered into a Biomass Power Generation Project Lease Agreement (the "2011 Shenqiu Lease"). Under the 2011 Shenqiu Lease, Xi'an TCH agreed to lease a set of 12 MW BMPG systems to Shenqiu at a monthly rental rate of \$286,000 (RMB 1.8 million) for 11 years. Upon expiration of the 2011 Shenqiu Lease, ownership of this system will transfer from Xi'an TCH to Shenqiu at no additional cost. In connection with the 2011 Shenqiu Lease, Shenqiu paid one month's rent as a security deposit to Xi'an TCH, in addition to providing personal guarantees.

On October 8, 2012, Xi'an TCH entered into a Letter of Intent for technical reformation of Shenqiu Project Phase II with Shenqiu for technical reformation to enlarge the capacity of the Shenqiu Project Phase I (the "Shenqiu Phase II Project"). The technical reformation involved the construction of another 12 MW BMPG system. After the reformation, the generation capacity of the power plant increased to 24 MW. The project commenced on October 25, 2012 and was completed during the first quarter of 2013. The total cost of the project was \$11.1 million (RMB 68 million). On March 30, 2013, Xi'an TCH and Shenqiu entered into a BMPG Project Lease Agreement (the "2013 Shenqiu Lease"). Under the 2013 Shenqiu Lease, Xi'an TCH agreed to lease the second set of 12 MW BMPG systems to Shenqiu for \$239,000 (RMB 1.5 million) per month for 9.5 years. When the 2013 Shenqiu Lease expires, ownership of this system will transfer from Xi'an TCH to Shenqiu at no additional cost.

*Pucheng Biomass Power Generation Projects*

On September 11, 2013, Xi'an TCH entered into a BMPG Asset Transfer Agreement (the "Pucheng Transfer Agreement") with Pucheng Xin Heng Yuan Biomass Power Generation Corporation ("Pucheng"), a limited liability company incorporated in China. The Pucheng Transfer Agreement provided for the sale by Pucheng to Xi'an TCH of a set of 12 MW BMPG systems with the completion of system transformation for a purchase price of RMB 100 million (\$16.48 million) in the form of 8,766,547 shares of common stock of the Company at \$1.87 per share. Also on September 11, 2013, Xi'an TCH also entered into a BMPG Project Lease Agreement with Pucheng (the "Pucheng Lease"). Under the Pucheng Lease, Xi'an TCH leases this same set of 12 MW BMPG system to Pucheng, and combines this lease with the lease for the 12 MW BMPG station of Pucheng Phase I project, under a single lease to Pucheng for RMB 3.8 million (\$0.63 million) per month (the "Pucheng Phase II Project"). The term for the consolidated lease is from September 2013 to June 2025. The lease agreement for the 12 MW station from Pucheng Phase I project

terminated upon the effective date of the Pucheng Lease. The ownership of two 12 MW BMPG systems will transfer to Pucheng at no additional charge when the Pucheng Lease expires.

*Chengli Waste Heat Power Generation Projects*

On July 24, 2013, Zhonghong entered into a Cooperative Agreement of CDQ and CDQ WHPG Project with Boxing County Chengli Gas Supply Co., Ltd. (“Chengli”). The parties entered into a supplement agreement on July 26, 2013. Pursuant to these agreements, Zhonghong agreed to design, build and maintain a 25 MW CDQ system and a CDQ WHPG system to supply power to Chengli, and Chengli agreed to pay energy saving fees (the “Chengli Project”). Chengli will contract the operation of the system to a third party contractor that is mutually agreed to by Zhonghong. In addition, Chengli will provide the land for the CDQ system and CDQ WHPG system at no cost to Zhonghong. The term of the Agreements is for 20 years. The first 800 million watt hours generated by the Chengli Project will be charged at RMB 0.42 (\$0.068) per KWH (excluding tax); thereafter, the energy saving fee will be RMB 0.20 (\$0.036) per KWH (excluding tax). The operating time shall be based upon an average 8,000 hours annually. If the operating time is less than 8,000 hours per year for each of Xuzhou Tian’an or Xuzhou Huayu due to a reason attributable to Chengli, then time charged shall be 8,000 hours a year, and if it is less than 8,000 hours due to a reason attributable to Zhonghong, then it shall be charged at actual operating hours. The construction of the Chengli Project was completed in the second quarter of 2015 and the project successfully completed commissioning tests in the first quarter of 2017. The Chengli Project is now operational, but will not begin operations until the Company receives the required power generating license, which the Company anticipates receiving in the third quarter of 2017. When operations begin, Chengli shall ensure its coking production line works properly and that working hours for the CDQ system are at least 8,000 hours per year, and Zhonghong shall ensure that working hours for the CDQ WHPG system are at least 7,200 hours per year.

On July 22, 2013, Zhonghong entered into an Engineering, Procurement and Construction (“EPC”) General Contractor Agreement for the Boxing County Chengli Gas Supply Co., Ltd. CDQ Power Generation Project (the “Huaxin Project”) with Xi’an Huaxin New Energy Co., Ltd. (“Huaxin”). Zhonghong, as the owner of the Huaxin Project, contracted EPC services for a CDQ system and a 25 MW CDQ WHPG system for Chengli from Huaxin. Huaxin shall provide construction, equipment procurement, transportation, installation and adjustment, test run, construction engineering management and other necessary services to complete the Huaxin Project and ensure the CDQ system and CDQ WHPG system for Chengli meet the inspection and acceptance requirements and work normally. The Huaxin Project is a turn-key project in which Huaxin is responsible for monitoring the quality, safety, duration and cost of the Chengli Project. The total contract price is RMB 200 million (\$33.34 million), which includes all materials, equipment, labor, transportation, electricity, water, waste disposal, machinery and safety costs.

#### *Tianyu Waste Heat Power Generation Project*

On July 19, 2013, Zhonghong entered into a Cooperative Agreement (the “Tianyu Agreement”) for Energy Management of CDQ and CDQ WHPG with Jiangsu Tianyu Energy and Chemical Group Co., Ltd (“Tianyu”). Pursuant to the Tianyu Agreement, Zhonghong will design, build, operate and maintain two sets of 25 MW CDQ and CDQ WHPG systems for two subsidiaries of Tianyu – Xuzhou Tian’an Chemical Co., Ltd (“Xuzhou Tian’an”) and Xuzhou Huayu Coking Co., Ltd. (“Xuzhou Huayu”) – to be located at Xuzhou Tian’an and Xuzhou Huayu’s respective locations (the “Tianyu Project”). Upon completion of the Tianyu Project, Zhonghong will charge Tianyu an energy saving fee of RMB 0.534 (\$0.087) per KWH (excluding tax). The operating time will be based upon an average 8,000 hours annually for each of Xuzhou Tian’an and Xuzhou Huayu. If the operating time is less than 8,000 hours per year due to a reason attributable to Tianyu, then time charged will be 8,000 hours a year. The construction of the Xuzhou Tian’an Project is anticipated to be completed by the third quarter of 2017. Xuzhou Tian’an will provide the land for the CDQ and CDQ WHPG systems for free. Xuzhou Tian’an also guarantees that it will purchase all of the power generated by the CDQ WHPG systems. The Xuzhou Huayu Project is currently on hold due to a conflict between Xuzhou Huayu Coking Co., Ltd. and local residents on certain pollution-related issues. The local government has acted in its capacity to coordinate the resolution of this issue. The local residents were requested to move from the hygienic buffer zone of the project location with compensatory payments from the government. Xuzhou Huayu was required to stop production and implement technical innovations to mitigate pollution discharge including sewage treatment, dust collection, noise control, and recycling of coal gas. Currently, some local residents have moved. Xuzhou Huayu has completed the implementation of the technical innovations of sewage treatment, dust collection, and noise control, and the Company is waiting for local governmental agencies to approve these technical innovations so that we can resume construction. We expect to complete the recycling of coal gas in the first half of 2018.. Once Huayu obtains the government’s acceptance and approval of the technical innovations, the project will resume.

On July 22, 2013, Xi’an Zhonghong New Energy Technology Co., Ltd. entered into an EPC General Contractor Agreement for the Xuzhou Tianyu Group CDQ Power Generation Project with Xi’an Huaxin New Energy Co., Ltd. (“Huaxin”). Zhonghong as the owner of the Project contracted EPC for the two sets of CDQ and 25 MW CDQ WHPG systems for Tianyu to Huaxin—one for Xuzhou Tian’an and one for Xuzhou Huayu. Huaxin shall provide construction, equipment procurement, transportation, installation and adjustment, test run, construction engineering management and other necessary works to complete the Project and ensure the CDQ and CDQ WHPG systems for Tianyu meet the

inspection and acceptance requirements and work normally. The project is a turn-key project and Huaxin is responsible for the quality, safety, duration and cost of the Project. The total contract price is RMB 400 million (\$66.67 million) of which RMB 200 million (\$33.34 million) is for the Xuzhou Tian'an system and RMB 200 million is for the Xuzhou Huayu system. The price is a cover-all price, which includes but not limited to all the materials, equipment, labor, transportation, electricity, water, waste disposal, machinery and safety matters.

*Yida Coke Oven Gas Power Generation Project*

On June 28, 2014, Xi'an TCH entered into an Asset Transfer Agreement (the "Transfer Agreement") with Qitaihe City Boli Yida Coal Selection Co., Ltd. ("Yida"), a limited liability company incorporated in China. The Transfer Agreement provided for the sale to Xi'an TCH of a 15 MW coke oven WPG station, which was converted from a 15 MW coal gangue power generation station from Yida. As consideration for the Transfer Asset, Xi'an TCH paid to Yida RMB 115 million (\$18.69 million) in the form of the common stock shares of the Company at the average closing price per share of the Stock for the 10 trading days prior to the closing date of the transaction (the "Shares"). The exchange rate between US Dollar and Chinese RMB in connection with the stock issuance was the rate equal to the middle rate published by the People's Bank of China on the closing date of the assets transfer.

On June 28, 2014, Xi'an TCH also entered into a Coke Oven Gas Power Generation Project Lease Agreement (the "Lease Agreement") with Yida. Under the Lease Agreement, Xi'an TCH leased the Transfer Asset to Yida for RMB 3 million (\$0.49 million) per month, and the term of the lease is from June 28, 2014 to June 27, 2029. Yida will also provide an RMB 3 million (\$0.49 million) security deposit (without interest) for the lease. Xi'an TCH will transfer the Transfer Asset back to Yida at no cost at the end of the lease term.

On June 22, 2016, Xi'an TCH entered into a Coal Oven Gas Power Generation Project Repurchase Agreement (the "Repurchase Agreement") with Yida. Under the Repurchase Agreement, Xi'an TCH agreed to transfer to Yida all the project assets for RMB 112,000,000 (\$16.89 million) (the "Transfer Price") with Yida's retention of ownership of the Shares. Yida agreed to make the following payments: (i) the outstanding monthly leasing fees for April and May 2016 of RMB 6,000,000 (\$0.90 million) to Xi'an TCH within 5 business days from the execution of the Repurchase Agreement; (ii) a payment of RMB 50,000,000 (\$7.54 million) of the Transfer Price to Xi'an TCH within 5 business days from the execution of the Repurchase Agreement; and (iii) a payment of the remaining RMB 62,000,000 (\$9.35 million) of the Transfer Price to Xi'an TCH within 15 business days from the execution of the Repurchase Agreement. Under the Repurchase Agreement, ownership of the project assets was transferred from Xi'an TCH to Yida within 3 business days after Xi'an TCH received the full Transfer Price and the outstanding monthly leasing fees. In July 2016, the Company received the full payment of the Transfer Price and title to the system was transferred at that time. The Company recorded a \$0.42 million loss from this transaction in 2016.

#### *Zhongtai WHPG Energy Management Cooperative Agreement*

On December 6, 2013, Xi'an entered into a CDQ and WHPG Energy Management Cooperative Agreement (the "Zhongtai Agreement") with Xuzhou Zhongtai Energy Technology Co., Ltd. ("Zhongtai"), a limited liability company incorporated in Jiangsu Province, China.

Pursuant to the Zhongtai Agreement, Xi'an TCH will design, build and maintain a 150 ton per hour CDQ system and a 25 MW CDQ WHPG system (the "Project") and sell the power to Zhongtai, and Xi'an TCH will also build a furnace to generate steam from the waste heat of the smoke pipeline and sell the steam to Zhongtai.

The construction period of the Project is expected to be 18 months from the date when conditions are ready for construction to begin. Zhongtai will start to pay an energy saving fee from the date when the WHPG station passes the required 72-hour test run. The term of payment is for 20 years. For the first 10 years of the term, Zhongtai shall pay an energy saving fee at RMB 0.534 (\$0.089) per KWH (including value added tax) for the power generated from the system. For the second 10 years of the term, Zhongtai shall pay an energy saving fee at RMB 0.402 (\$0.067) per KWH (including value added tax). During the term of the contract the energy saving fee shall be adjusted at the same percentage as the change of local grid electricity price. Zhongtai shall also pay an energy saving service fee for the steam supplied by Xi'an TCH at RMB 100 (\$16.67) per ton (including value added tax). Zhongtai and its parent

company will provide guarantees to ensure Zhongtai will fulfill its obligations under the Agreement. Upon the completion of the term, Xi'an TCH will transfer the systems to Zhongtai at RMB 1 (\$0.16). Zhongtai shall provide waste heat to the systems for no less than 8,000 hours per year and waste gas volume no less than 150,000 Nm<sup>3</sup> per hour with a temperature no less than 950°C. If these requirements are not met, the term of the Zhongtai Agreement will be extended accordingly. If Zhongtai wants to terminate the Zhongtai Agreement early, it shall provide Xi'an TCH a 60 day notice and pay the termination fee and compensation for the damages to Xi'an TCH according to the following formula: (i) if it is less than five years into the term when Zhongtai requests termination, Zhongtai shall pay: Xi'an TCH's total investment amount plus Xi'an TCH's annual investment return times five years minus the years in which the system has already operated; or (ii) if it is more than five years into the term when Zhongtai requests the termination, Zhongtai shall pay Xi'an TCH's total investment amount minus total amortization cost (the amortization period is 10 years).

On March 14, 2016, Xi'an TCH entered into a Xuzhou Zhongtai CDQ and Waste Heat Power Generation System Transfer Agreement (the "Transfer Agreement") with Zhongtai and Xi'an Huaxin New Energy Co., Ltd., a limited liability company incorporated in China (the "Contractor").

The Transfer Agreement provides for the sale to Zhongtai of all the assets of the Project under construction from Xi'an TCH. Additionally, Xi'an TCH will transfer to Zhongtai the Engineering, Procurement and Construction ("EPC") Contract for the Project, which Xi'an TCH had entered into with the Contractor in connection with the Project. As consideration for the transfer of the Project, Zhongtai is to pay to Xi'an TCH an aggregate purchase price of RMB 167,360,000 (\$25.75 million and the "Transfer Price"), on the following schedule: (i) RMB 50,000,000 (\$7.69 million) of the Transfer Price was paid within 20 business days from the execution of the Transfer Agreement; (ii) RMB 30,000,000 (\$4.32 million) of the Transfer Price was paid within 20 business days upon the completion of the construction of the Project but not later than July 30, 2016; and (iii) RMB 87,360,000 (\$13.45 million) of the Transfer Price will be paid before July 30, 2017. The temporary ownership of the Project was transferred from Xi'an TCH to Zhongtai after the Xi'an TCH received the first payment of RMB 50,000,000, and the full ownership of the Project is to be officially transferred to Zhongtai upon full payment of the Transfer Price. The Zhongtai Agreement is to be terminated and Xi'an TCH will agree not to pursue any breach of contract liability against the Zhongtai under the Zhongtai Agreement when Zhongtai fully pays the Transfer Price according to the terms of the Transfer Agreement. If the Transfer Price is not fully paid on time pursuant to the Transfer Agreement, the Transfer Agreement automatically terminates and Xi'an TCH retains ownership of the Project, and both parties would continue to possess their respective rights and obligations according to the Zhongtai Agreement and assume the liabilities for breach of the Zhongtai Agreement. Xuzhou Taifa Special Steel Technology Co., Ltd. ("Xuzhou Taifa") has guaranteed the payments by Zhongtai. As of June 30, 2017, Xi'an TCH had received the first payment of \$7.70 million and the second payment of \$4.32 million. The Company recorded a \$2.82 million loss from this transaction in 2016. As of this report date, the Company has not yet received the remaining payment of RMB 87,360,000 (\$13.45 million), the Company expects to collect this remaining balance during the third quarter of 2017.

#### *Rongfeng CDQ Power Generation Energy Management Cooperative Agreement*

On December 12, 2013, Xi'an TCH entered into a CDQ Power Generation Energy Management Cooperative Agreement with Tangshan Rongfeng Iron & Steel Co., Ltd. (the "Rongfeng Agreement"), a limited liability company incorporated in Hebei Province, China.

Pursuant to the Rongfeng Agreement, Xi'an TCH will design, build and maintain a CDQ system and a CDQ WHPG system and sell the power to Rongfeng. The construction period of the Project is expected to be eighteen (18) months after the Agreement takes effect and from the date when conditions are ready for construction to begin.

Rongfeng will start to pay an energy saving fee from the date when the WHPG station passes the required 72-hour test run. The term of payment is for 20 years. For the first 10 years of the term, Rongfeng shall pay an energy saving fee at RMB 0.582 (\$0.095) per KWH (including tax) for the power generated from the system. For the second 10 years of the term, Rongfeng shall pay an energy saving fee at RMB 0.432 (\$0.071) per KWH (including tax). During the term of the contract the energy saving fee shall be adjusted at the same percentage as the change of local grid electricity price. Rongfeng and its parent company will provide guarantees to ensure Rongfeng will fulfill its obligations under the Rongfeng Agreement. Upon the completion of the term, Xi'an TCH will transfer the systems to Rongfeng at RMB



1. Rongfeng shall provide waste heat to the systems for no less than 8,000 hours per year with a temperature no less than 950°C. If these requirements are not met, the term of the Agreement will be extended accordingly. If Rongfeng wants to terminate the Agreement early, it shall provide Xi'an TCH a 60 day notice and pay the termination fee and compensation for the damages to Xi'an TCH according to the following formula: 1) if it is less than or equal to five years into the term when Rongfeng requests termination, Rongfeng shall pay: Xi'an TCH's total investment amount plus Xi'an TCH's average annual investment return times five years minus the years of which the system has already operated); 2) if it is more than five years into the term when Rongfeng requests the termination, Rongfeng shall pay: Xi'an TCH's total investment amount minus total amortization cost (the amortization period is 10 years).

On November 16, 2015, Xi'an TCH entered into a Transfer Agreement of CDQ and a CDQ WHPG system with Rongfeng and Xi'an Huaxin New Energy Co., Ltd., a limited liability company incorporated in China ("Xi'an Huaxin"). The Transfer Agreement provided for the sale to Rongfeng of the CDQ Waste Heat Power Generation Project (the "Project") from Xi'an TCH. Additionally, Xi'an TCH would transfer to Rongfeng the Engineering, Procurement and Construction ("EPC") Contract for the CDQ Waste Heat Power Generation Project which Xi'an TCH had entered into with Xi'an Huaxin in connection with the Project. As consideration for the transfer of the Project, Rongfeng is to pay to Xi'an TCH an aggregate purchase price of RMB 165,200,000 (\$25.45 million) on the following schedule: (i) RMB 65,200,000 (\$10.05 million) was paid by Rongfeng to Xi'an TCH within 20 business days after signing the Transfer Agreement, (ii) RMB 50,000,000 (\$7.70 million) was paid by Rongfeng to Xi'an TCH within 20 business days after the Project is completed, but no later than March 31, 2016, and (iii) RMB 50,000,000 (\$7.70 million) will be paid by Rongfeng to Xi'an TCH no later than September 30, 2016. Mr. Cheng Li, the largest stockholder of Rongfeng, has personally guaranteed the payments. The ownership of the Project was conditionally transferred to Rongfeng within 3 business days following the initial payment of RMB 65,200,000 (\$10.05 million) by Rongfeng to Xi'an TCH, and the full ownership of the Project will be transferred to Rongfeng after it completes the entire payment pursuant to the terms of the Transfer Agreement. The Company recorded a \$3.78 million loss from this transaction in 2015. As of December 31, 2016, the Company had received payment in full of \$25.45 million.

## **Related Party Transactions**

As of June 30, 2017, the Company had \$41,775 in advances from the Company's management, which bear no interest, and are payable upon demand.

On August 27, 2014, the Company entered into a Share Purchase Agreement (the "Agreement") with Mr. Guohua Ku, a major stockholder and the Company's Chairman and Chief Executive Officer. Pursuant to the Agreement, the Company issued to Mr. Ku 1,382,908 shares of the Company's common stock (the "Shares") on September 5, 2014 (adjusted for the 1:10 reverse stock split). The purchase price per share for the Shares was the average closing price quoted on the NASDAQ Global Market for the common stock of the Company for 15 trading days prior to the effective date of the Agreement, which was \$1.37 per share. The Company received payments in two installments of \$12 million and \$6.91 million on September 5, 2014 and September 12, 2014, respectively, in equivalent of RMB 74.05 million and RMB 42.85 million, respectively, using the middle exchange rate between USD and RMB published by the People's Bank of China on the effective date of the agreement pursuant to its terms. These shares were recorded using the fair value of \$1.49 per share. The Company filed a registration statement registering the Shares for resale on Form S-3 (Reg. No. 333-214834), which was declared effective by the Securities and Exchange Commission on December 20, 2016.

During the six and three months ended June 30, 2017, the Company recognized RMB 13.47 million (\$1.96 million) and RMB 6.67 million (\$0.97 million), respectively, interest income for sales-type lease of Pucheng BMPG systems from Pucheng Xin Heng Yuan Biomass Power Generation Corporation, whose major stockholder became a stockholder of CREG through the issuance of the Company's common stock to this stockholder in consideration for the transfer of the old system to CREG for BMPG system transformation.

Also during 2016, prior to the repurchase date of June 22, 2016, the Company recognized RMB 13.83 million (\$2.09 million) interest income for sales-type lease of Yida WGPG system from Qitaihe City Boli Yida Coal Selection Co., Ltd., whose major stockholder became a stockholder of CREG through the issuance of the Company's common stock to this stockholder in consideration for the transfer of the old system to CREG for WGPG system transformation.

## **Critical Accounting Policies and Estimates**

Our management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements ("CFS"), which were prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of

contingent assets and liabilities at the date of the financial statements as well as the reported net sales and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates on historical experience and various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

### **Basis of Presentation**

These accompanying CFS were prepared in accordance with US GAAP and pursuant to the rules and regulations of the SEC for financial statements.

### **Basis of Consolidation**

The CFS include the accounts of CREG and, its subsidiary, Sifang Holdings and Yinghua; Sifang Holdings' wholly-owned subsidiaries, Huahong and Shanghai TCH; Shanghai TCH's wholly-owned subsidiary Xi'an TCH; and Xi'an TCH's subsidiaries, Erdos TCH, Zhonghong, and Zhongxun. Substantially all of the Company's revenues are derived from the operations of Shanghai TCH and its subsidiaries, which represent substantially all of the Company's consolidated assets and liabilities as of June 30, 2017 and December 31, 2016, respectively. All significant inter-company accounts and transactions were eliminated in consolidation.

### **Use of Estimates**

In preparing the CFS, management makes estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheets as well as revenues and expenses during the year reported. Actual results may differ from these estimates.

### **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 in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC.

### **Accounts Receivable**

As of June 30, 2017, the Company had accounts receivable of \$12,895,607 (from sale of CDQ and a CDQ WHPG system to Zhongtai). As of December 31, 2016, the Company had accounts receivable of \$12,593,340 (from sale of CDQ and a CDQ WHPG system to Zhongtai).

### **Interest Receivable on Sales Type Leases**

As of June 30, 2017, the interest receivable on sales type leases was \$7,695,920, mainly representing recognized but not yet collected interest income for the Pucheng and Shenqiu systems. As of December 31, 2016, the interest receivable on sales type leases was \$4,621,491.

The Company maintains reserves for potential credit losses on receivables. Management reviews the composition of receivables 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. Pucheng and Shenqiu each resumed production in April, 2017 and repayment began in May, 2017. The Shenqiu and Pucheng users have a good record of payment and have promised to repay the due amount gradually after production resumes. Based on an evaluation of the collectability, the Company did not record any bad debt allowances at June 30, 2017 and December 31, 2016.

## **Revenue Recognition**

### *Sales-type Leasing and Related Revenue Recognition*

The Company constructs and then leases waste energy recycling power generating projects to its customers. The Company typically transfers ownership of the waste energy recycling power generating projects to its customers at the end of each lease. Investment in these projects is recorded as investment in sales-type leases in accordance with “Accounting for Leases”, codified in Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 840 and its various amendments and interpretations. The Company manufactures and constructs waste energy recycling power generating projects and finances its customers for the costs of the projects. The sales and cost of sales are recognized at the time of sale or inception of the lease. The investment in sales-type leases consists of the sum of the total minimum lease payments receivable less unearned interest income and estimated executory cost. Unearned interest income is amortized to income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease. While a portion of revenue is recognized at the inception of the lease, the cash flow from the sales-type lease occurs over the course of the lease. Revenue is net of the Value Added Tax.

### *Contingent Rental Income*

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

## **Foreign Currency Translation and Comprehensive Income (Loss)**

The Company’s functional currency is RMB. For financial reporting purposes, RMB figures were translated into USD as the reporting currency. Assets and liabilities are translated at the exchange rate in effect on the balance sheet date. Revenues and expenses are translated at the average rate of exchange prevailing during the reporting period. Translation adjustments arising from the use of different exchange rates from period to period are included as a component of stockholders’ equity as “Accumulated other comprehensive income.” Gains and losses from foreign currency transactions are included in income. There has been no significant fluctuation in exchange rate for the conversion of RMB to USD after the balance sheet date.

The Company uses “Reporting Comprehensive Income” (codified in FASB ASC Topic 220). Comprehensive income is comprised of net income and all changes to the statements of stockholders’ equity, except those due to investments by

stockholders, changes in paid-in capital and distributions to stockholders.

## RESULTS OF OPERATIONS

### Comparison of Three Months Ended June 30, 2017 and 2016

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

	2017		2016		
		% of Sales		% of Sales	
Sales	\$-	-	\$-	-	%
Sales of systems	-	-	-	-	%
Contingent rental income	-	-	-	-	%
Cost of sales	-	-	-	-	%
Cost of systems and contingent rental income	-	-	-	-	%
Gross profit	-	-	-	-	%
Interest income on sales-type leases	2,202,995	-	3,778,299	-	%
Total operating income	2,202,995	-	3,778,299	-	%
Total operating expenses	(230,240 )	-	(365,371 )	-	%
Income from operations	1,972,755	-	3,412,928	-	%
Total non-operating expenses, net	(1,327,413 )	-	(2,344,466 )	-	%
Income before income tax	645,342	-	1,068,462	-	%
Income tax expense	365,663	-	(1,183,539 )	-	%
Less: net loss attributable to noncontrolling interest	(89,832 )	-	(95,925 )	-	%
Net income attributable to China Recycling Energy Corp	\$369,511	-	\$2,347,926	-	%

*SALES.* Total sales for the three months ended June 30, 2017 and 2016 were \$0. For the three months ended June 30, 2017 and 2016, the Company had no sales of systems or contingent rental income. For the sales-type leases, sales and COS are recorded at the time of the lease; in addition to sales revenue, our other major source of revenue is interest income from the sales-type leases.

*COST OF SALES.* Cost of sales (“COS”) for the three months ended June 30, 2017 and 2016 were \$0. We did not have any contingent rental income, or finish any new construction or sale any new system, in the three months ended June 30, 2017.

*GROSS PROFIT.* Gross profit and gross margin for the three months ended June 30, 2017 and 2016 were \$0 and 0%, respectively.

*INTEREST INCOME ON SALES-TYPE LEASES.* Interest income on sales-type leases for the three months ended June 30, 2017 was \$2.20 million, a \$1.58 million decrease from \$3.78 million for the three months ended June 30, 2016. During the three months ended June 30, 2017, interest income was derived from the following nine (9) sales-type leases:

- i. Two BMPG systems to Pucheng Phase I and II (15 and 11.9 years, respectively);
- ii. One BMPG system to Shenqiu Phase I (11 years);
- iii. One BMPG system to Shenqiu Phase II (9.5 years);
- iv. Five power and steam generating systems to Erdos (20 years);

On April 28, 2016, Erdos TCH and Erdos entered a supplemental agreement, effective on May 1, 2016, whereby Erdos TCH cancelled monthly minimum lease payments from Erdos, and charges Erdos based on actual electricity sold at RMB 0.30 / KWH. The selling price of each KWH will be determined annually based on prevailing market conditions.

In comparison, during the three months ended June 30, 2016, interest income was derived from the following 10 sales-type leases:

- i. Two BMPG systems to Pucheng Phase I and II (15 and 11.9 years, respectively);



- ii. One BMPG system to Shenqiu Phase I (11 years);
- iii. One BMPG system to Shenqiu Phase II (9.5 years);
- iv. Five power and steam generating systems to Erdos (20 years);
- v. One WGPG system to Yida (15 years but sold in the 2<sup>nd</sup> quarter of 2016).

*OPERATING EXPENSES.* Operating expenses consisted of general and administrative expenses totaling \$230,240 for the three months ended June 30, 2017, compared to \$365,371 general and administrative expenses for the comparable period of 2016, a decrease of \$135,131 or 37%. The decrease was mainly due to decreased payroll expenses of \$33,800, entertainment expenses of \$14,300, travel expenses of \$11,800, rental expenses of \$7,000, and vehicle expenses of \$4,900. These decreases in operating expenses were a result of our disposal of certain power generating systems, which led to decreased employee headcount and associated expenses.

*NET NON-OPERATING EXPENSES.* Net non-operating expenses consisted of non-sales-type lease interest income, interest expenses, loss on sale of construction in progress and miscellaneous expenses. For the three months ended June 30, 2017, net non-operating expense was \$1.33 million compared to net non-operating expense of \$2.34 million for the three months ended June 30, 2016. For the three months ended June 30, 2017, we had \$34,844 interest income and \$3,275 other income, but the amounts were offset by a \$1.37 million interest expense on loans. For the three months ended June 30, 2016, we had a \$31,814 interest income and a \$74,091 other income, but the amounts were offset by a \$2.03 million interest expense and a \$417,952 loss on the system repurchase from Yida.

*INCOME TAX EXPENSE.* Income tax expense was \$0.37 million for the three months ended June 30, 2017, compared with \$1.18 million income tax benefit for the comparable period of 2016. The consolidated effective income tax (benefit) rate for the three months ended June 30, 2017 and 2016 were 57% and (111)%, respectively. The decrease in income tax benefit in the three months ended June 30, 2017 was mainly due to the higher income tax benefit from loss from disposal of fixed assets of Xuzhou Zhongtai and Yida systems in the comparable period of 2016 per PRC tax return purpose. Xi'an TCH's income tax rate was 25% for each of 2017 and 2016.

*NET INCOME.* Net income for the three months ended June 30, 2017 was \$0.37 million compared to net income of \$2.35 million for the three months ended June 30, 2016, a decrease of \$1.98 million. This decrease in net income was mainly due to the decreased interest income on sales-type leases and increased income tax expense in the three months ended June 30, 2017.

### Comparison of Six Months Ended June 30, 2017 and 2016

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

	2017		2016		
		% of		% of	
		Sales		Sales	
Sales	\$-	- %	\$6,759	100 %	
Sales of systems	-	- %	-	- %	
Contingent rental income	-	- %	6,759	100 %	
Cost of sales	-	- %	8,125	120 %	
Cost of systems and contingent rental income	-	- %	8,125	120 %	
Gross profit	-	- %	(1,366 )	(20 )%	
Interest income on sales-type leases	4,331,011	- %	8,659,829	128123 %	
Total operating income	4,331,011	- %	8,658,463	128123 %	
Total operating expenses	(339,301 )	- %	(854,784 )	(12647 )%	

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Income from operations	3,991,710	-	%	7,803,679	115456%
Total non-operating expenses, net	(2,644,067)	-	%	(6,482,700)	(95912)%
Income before income tax	1,347,643	-	%	1,320,979	19544%
Income tax expense (benefit)	781,966	-	%	(972,768)	(14392)%
Less: net loss attributable to noncontrolling interest	(178,255)	-	%	(147,205)	(2178)%
Net income attributable to China Recycling Energy Corp	\$743,932	-	%	\$2,440,952	36114%

*SALES.* Total sales for the six months ended June 30, 2017 were \$0, while total sales for the comparable period of 2016 were \$6,759, a decrease of \$6,759. Of the total sales, sales of systems for the six months ended June 30, 2017 and 2016 were \$0. For the six months ended June 30, 2017, the Company had contingent rental income of \$0, compared to \$6,759 of contingent rental income from the usage of electricity in addition to the minimum lease payments for the comparable period in 2016. For the sales-type leases, sales and COS are recorded at the time of the lease; in addition to sales revenue, our other major source of revenue is interest income from the sales-type leases.

*COST OF SALES.* COS for the six months ended June 30, 2017 was \$0, while our COS for the comparable period of 2016 was \$8,125, a decrease of \$8,125. We did not have any contingent rental income, or finish any new construction or sale any new system, in the six months ended June 30, 2017; while in the comparable period of 2016, we had cost of contingent rental income of \$8,125.

*GROSS PROFIT.* Gross profit was \$0 for the six months ended June 30, 2017, compared to gross loss of \$1,366 for the comparable period of 2016, representing a blended gross (loss) margin of 0% and (20)% for the comparable periods of 2017 and 2016, respectively. The decrease in blended gross loss margin in the six months ended June 30, 2017 was primarily due to no sales of systems or contingent rental income and no cost of sales for the six months ended June 30, 2017, compared to contingent rental income of \$6,759 and cost of contingent rental income of \$8,125 for the six months ended June 30, 2016.

*INTEREST INCOME ON SALES-TYPE LEASES.* Interest income on sales-type leases for the six months ended June 30, 2017 was \$4.33 million, a \$4.33 million decrease from \$8.66 million for the six months ended June 30, 2016. During the six months ended June 30, 2017, interest income was derived from the following nine sales-type leases:

- i. Two BMPG systems to Pucheng Phase I and II (15 and 11.9 years, respectively);
- ii. One BMPG system to Shenqiu Phase I (11 years);
- iii. One BMPG system to Shenqiu Phase II (9.5 years);
- iv. Five power and steam generating systems to Erdos (20 years);

On April 28, 2016, Erdos TCH and Erdos entered a supplemental agreement, effective on May 1, 2016, whereby Erdos TCH cancelled monthly minimum lease payments from Erdos, and charges Erdos based on actual electricity sold at RMB 0.30 / KWH. The selling price of each KWH will be determined annually based on prevailing market conditions.

In comparison, during the six months ended June 30, 2016, interest income was derived from the following 10 sales-type leases:

- i. Two BMPG systems to Pucheng Phase I and II (15 and 11.9 years, respectively);
- ii. One BMPG system to Shenqiu Phase I (11 years);
- iii. One BMPG system to Shenqiu Phase II (9.5 years);
- iv. Five power and steam generating systems to Erdos (20 years);
- v. One WPG system to Yida (15 years but sold in 2<sup>nd</sup> quarter of 2016).

*OPERATING EXPENSES.* Operating expenses consisted of general and administrative expenses totaling \$339,301 for the six months ended June 30, 2017, compared to \$854,784 general and administrative expenses for the comparable period of 2016, a decrease of \$515,483 or 60%. The decrease was mainly due to decreased payroll expenses of \$73,500, entertainment expenses of \$24,900, travel expenses of \$22,100, office expenses of \$20,000, and vehicle expenses of \$12,300. These decreases in operating expenses were a result of our disposal of certain power generating systems, which led to decreased employee headcount and associated expenses.

*NET NON-OPERATING EXPENSES.* Net non-operating expenses consisted of non-sales-type lease interest income, interest expenses, loss on sale of construction in progress and miscellaneous expenses. For the six months ended June 30, 2017, net non-operating expense was \$2.64 million compared to net non-operating expense of \$6.48 million for the six months ended June 30, 2016. For the six months ended June 30, 2017, we had \$70,877 interest income and \$7,798 other income, but the amounts were offset by a \$2.72 million interest expense on loans. For the six months ended June 30, 2016, we had a \$63,502 interest income and a \$76,418 other income, but the amounts were offset by a \$3.38 million interest expense, a \$2.82 million loss from the sale of construction in progress of Xuzhou Zhongtai project, and a \$0.42 million loss from loss on the system repurchase from Yida.

**INCOME TAX EXPENSE.** Income tax expense was \$0.78 million for the six months ended June 30, 2017, a decrease of \$1.75 million from \$0.97 million income tax benefit for the comparable period of 2016. The consolidated effective income tax (benefit) rate for the six months ended June 30, 2017 and 2016 were 58% and (74)%, respectively. The decrease in income tax benefit in the six months ended June 30, 2017 was mainly due to the higher income tax benefit from loss from disposal of fixed assets of the Xuzhou Zhongtai and Yida systems in the comparable period of 2016 per PRC tax return purpose. Xi'an TCH's income tax rate was 25% for each of 2017 and 2016.

**NET INCOME.** Net income for the six months ended June 30, 2017 was \$0.74 million compared to net income of \$2.44 million for the six months ended June 30, 2016, a decrease of \$1.70 million. This decrease in net income was mainly due to the decreased interest income on sales-type leases and increased income tax expense in the six months ended June 30, 2017.

## Liquidity and Capital Resources

### Comparison of the six months ended June 30, 2017 and 2016

As of June 30, 2017, the Company had cash and equivalents of \$46.98 million, other current assets of \$36.41 million, current liabilities of \$57.73 million, working capital of \$25.66 million, a current ratio of 1.44:1 and a debt-to-equity ratio of 0.26:1.

The following is a summary of cash provided by or used in each of the indicated types of activities during the six months ended June 30, 2017 and 2016:

	2017	2016
Cash provided by (used in):		
Operating Activities	\$(1,182,172)	\$24,061,791
Investing Activities	-	572,715
Financing Activities	(727,834 )	(22,755,189)

Net cash used in operating activities was \$1.18 million during the six months ended June 30, 2017, compared to \$24.06 million provided by operating activities in the comparable period of 2016. The decrease in net cash inflow in the six months ended June 30, 2017 was mainly due to a decrease in cash inflow from construction in progress by \$23.63 million as a result of the disposal of construction in progress of Xuzhou Zhongtai in the comparable period of 2016, an increased cash outflow for interest receivable on sales type leases by \$1.96 million, an increased cash

outflow for notes receivable by \$0.79 million, and a decreased cash inflow from collection of principal on sales type leases by \$19.09 million. However, the decrease in cash inflow was partially offset by a decreased cash outflow on accounts receivable by \$19.81 million and an increased cash inflow from interest payable on an entrusted loan by \$3.75 million.

Net cash provided by investing activities was \$0 for the six months ended June 30, 2017, compared to net cash provided by investing activities of \$0.57 million in the comparable period of 2016. We had \$0.57 million cash inflow from change in restricted cash in the six months ended June 30, 2016.

Net cash used in financing activities was \$0.73 million for the six months ended June 30, 2017 compared to net cash used in financing activities of \$22.76 million for the six months ended June 30, 2016. The cash outflow in the six months ended June 30, 2017 came from the \$0.73 million repayment of bank loans. In comparison, during the six months ended June 30, 2016, we had \$22.76 million in repayments of bank loans.

We believe we have sufficient cash to continue our current business through 2017 based on recurring receipts from existing sales-type leases. As of June 30, 2017, we had five recycling WHPG systems from the Erdos projects and four BMPG systems (two for Pucheng and two for Shenqiu), all of which generate cash flow. In addition, we have access to bank loans in case of an immediate need for working capital. We believe we have sufficient cash resources to cover our anticipated capital expenditures in 2017. The 9 systems that are currently in operation have minimum monthly lease payments of RMB 7.97 million (\$1.18 million).

We do not believe inflation has had or will have a significant negative impact on our results of operations in 2017.

## Transfers of Cash to and from Our Subsidiaries

The PRC has currency and capital transfer regulations that require us to comply with certain requirements for the movement of capital. The Company is able to transfer cash (US Dollars) to its PRC subsidiaries through: (i) an investment (by increasing the Company's registered capital in a PRC subsidiary), or (ii) a stockholder loan. Except as described below, the Company's subsidiaries in the PRC have not transferred any earnings or cash to the Company to date. The Company's business is primarily conducted through its subsidiaries. The Company is a holding company and its material assets consist solely of the ownership interests held in its PRC subsidiaries. The Company relies on dividends paid by its subsidiaries for its working capital and cash needs, including the funds necessary: (i) to pay dividends or cash distributions to its stockholders, (ii) to service any debt obligations and (iii) to pay operating expenses. As a result of PRC laws and regulations (noted below) that require annual appropriations of 10% of after-tax income to be set aside in a general reserve fund prior to payment of dividends, the Company's PRC subsidiaries are restricted in that respect, as well as in others respects noted below, in their ability to transfer a portion of their net assets to the Company as a dividend.

With respect to transferring cash from the Company to its subsidiaries, increasing the Company's registered capital in a PRC subsidiary requires the pre-approval of the local commerce department, while a stockholder loan requires a filing with the state administration of foreign exchange or its local bureau.

With respect to the payment of dividends, we note the following:

PRC regulations currently permit the payment of dividends only out of accumulated profits, as determined in accordance with accounting standards and PRC regulations (an in-depth description of the PRC regulations is set forth below);

Our PRC subsidiaries are required to set aside, at a minimum, 10% of their net income after taxes, based on PRC accounting standards, each year as statutory surplus reserves until the cumulative amount of such reserves reaches 50% of their registered capital;

3. Such reserves may not be distributed as cash dividends;

Our PRC subsidiaries may also allocate a portion of their after-tax profits to fund their staff welfare and bonus funds; except in the event of a liquidation, these funds may also not be distributed to stockholders; the Company does not participate in a Common Welfare Fund;



5. The incurrence of debt, specifically the instruments governing such debt, may restrict a subsidiary's ability to pay stockholder dividends or make other cash distributions; and

6. The Company is subject to covenants and consent requirements.

If, for the reasons noted above, our subsidiaries are unable to pay stockholder dividends and/or make other cash payments to the Company when needed, the Company's ability to conduct operations, make investments, engage in acquisitions, or undertake other activities requiring working capital may be materially and adversely affected. However, our operations and business, including investment and/or acquisitions by our subsidiaries within China, will not be affected as long as the capital is not transferred in or out of the PRC.

### *PRC Regulations*

In accordance with 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 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). The aforementioned reserves may only be used for specific purposes and may not be distributed as cash dividends. Until such contribution of capital is satisfied, the FIE is not allowed to repatriate profits to its stockholders, unless approved by the State Administration of Foreign Exchange. After satisfaction of this requirement, the remaining funds may be appropriated at the discretion of the FIE's board of directors. Our subsidiary, Shanghai TCH, qualifies as an FIE and is therefore subject to the above-mandated regulations on distributable profits.

Additionally, in accordance with PRC corporate law, a domestic enterprise is required to maintain a surplus reserve of 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 board of directors, from the profits determined in accordance with the enterprise's PRC statutory accounts. The aforementioned reserves can only be used for specific purposes and may not be distributed as cash dividends. Xi'an TCH, Huahong, and Erdos TCH were established as domestic enterprises; therefore, each is subject to the above-mentioned restrictions on distributable profits.

As a result of PRC laws and regulations that require annual appropriations of 10% of after-tax income to be set aside, prior to payment of dividends, in a 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 or otherwise.

#### *Chart of the Company's Statutory Reserve*

Pursuant to PRC corporate law, effective January 1, 2006, the Company is required to maintain a statutory reserve by appropriating from its after-tax profit before declaration or payment of dividends. The statutory reserve represents restricted retained earnings. Our restricted and unrestricted retained earnings under US GAAP are set forth below:

	As at	
	June 30, 2017	December 31, 2016
Unrestricted retained earnings	\$86,319,512	\$85,838,638
Restricted retained earnings (surplus reserve fund)	14,736,982	14,473,924
Retained earnings (including surplus reserve fund)	\$101,056,494	\$100,312,562

#### **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. 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's contractual obligations as of June 30, 2017 are as follows:

Contractual Obligation	<b>1 year or less</b>	<b>More than 1 year</b>	<b>See Note (for details)</b>
Entrusted loan	48,712,801	295,229	12
Total	\$48,712,801	\$295,229	

The Company believes that it has a stable cash inflow each month and a sufficient channel to commercial institutions to obtain any loans that may be necessary to meet its working capital needs. Historically, we have been able to obtain loans or otherwise achieve our financing objectives due to the Chinese government's support for energy-saving businesses with stable cash inflows, good credit ratings and history. The Company does not believe it will have difficulties related to the repayment of its outstanding short-term loans.

## Commitments

### *Boxing Chengli Power Generation Projects*

On July 24, 2013, Zhonghong entered into a Cooperative Agreement of CDQ and CDQ WHPG Project with Boxing County Chengli Gas Supply Co., Ltd. ("Chengli"), including a supplement agreement entered by the parties on July 26, 2013.

Pursuant to the agreements, Zhonghong will design, build and maintain a CDQ system and a 25 MW CDQ WHPG system to supply power to Chengli, and Chengli will pay energy saving fees. Chengli will contract the operation of the system to a third party contractor that is mutually agreed to by Zhonghong. In addition, Chengli will provide the land for the CDQ and CDQ WHPG system at no cost to Zhonghong. The term of the Agreements is 20 years. The energy saving fees generated by the Project will be charged at RMB 0.42 (\$0.068) per KWH (excluding tax). The operating time shall be based upon an average 8,000 hours annually. If the operating time is less than 8,000 hours due to a reason attributable to Chengli's, then time charged shall be 8,000 hours a year, and if it is less than 8,000 hours due to a reason attributable to Zhonghong, then it shall be charged at actual operating hours. The construction of the Project was completed in the second quarter of 2015, and the commissioning tests were successfully completed in the first quarter of 2017. The Chengli Project is now operational, but will not begin operations until the Company receives the required power generating license, which the Company anticipates receiving in the third quarter of 2017. From the date of the operation, Chengli shall ensure its coking production line works properly and that working hours for the CDQ system are no less than 8,000 hours/year, while Zhonghong shall ensure that working hours for the CDQ WHPG system are no less than 7,200 hours/year.

On July 22, 2013, Xi'an Zhonghong New Energy Technology Co., Ltd. entered into an EPC General Contractor Agreement for the Boxing County Chengli Gas Supply Co., Ltd. CDQ Power Generation Project (the "Project") with Xi'an Huaxin New Energy Co., Ltd. ("Huaxin"). Zhonghong as the owner of the Project contracted EPC for a CDQ and a 25 MW CDQ WHPG system for Chengli from Huaxin. Huaxin shall provide construction, equipment procurement, transportation, installation and adjustment, test run, construction engineering management and other necessary works to complete the Project and ensure the CDQ and CDQ WHPG system for Chengli meet the inspection and acceptance requirements and work normally. The project is a turn-key project and Huaxin is responsible for the quality, safety, duration and cost of the Project. The total contract price is RMB 200 million (\$28.83 million). The price is a cover-all

price which includes but is not limited to all the materials, equipment, labor, transportation, electricity, water, waste disposal, machinery and safety matters. As of June 30, 2017, the Chengli project had finished construction, but was waiting for government approval before beginning operations.

*Xuzhou Tian'an and Xuzhou Huayu CDQ Power Generation Projects*

On July 19, 2013, Zhonghong entered into a Cooperative Agreement for Energy Management of CDQ and CDQ WHPG Project (the "Tianyu Project") with Jiangsu Tianyu Energy and Chemical Group Co., Ltd. ("Tianyu").

Pursuant to the Tianyu Agreement, Zhonghong will design, build, operate and maintain two sets of 25 MW CDQ and CDQ WHPG systems for two subsidiaries of Tianyu: one is for and will be located at Xuzhou Tian'an Chemical Co., Ltd and one set is for and will be located at Xuzhou Huayu Coking Co., Ltd. Upon the completion of the Tianyu Project, Zhonghong will charge Tianyu an energy saving service fee of RMB 0.534 (\$0.088) per KWH (excluding tax). The operating time shall be based upon an average 8,000 hours annually for each of Tian'an and Huayu. If the operating time for each of Tian'an and Huayu is less than 8,000 hours a year due to the reason attributable to Tianyu, then time charged shall be 8,000 hours a year for each of Tian'an and Huayu. Xuzhou Tian'an and Huayu will provide the land for the CDQ and CDQ WHPG systems for free. Xuzhou Tian'an and Huayu also guarantee that they will purchase all of the power generated by the CDQ WHPG systems.

On July 22, 2013, Xi'an Zhonghong New Energy Technology Co., Ltd. entered into an EPC General Contractor Agreement for the Xuzhou Tianyu Group CDQ Power Generation Project (the "Project") with Xi'an Huaxin New Energy Co., Ltd. ("Huaxin"). Zhonghong as the owner of the Project contracted EPC for the two sets of CDQ and 25 MW CDQ WHPG systems for Tianyu to Huaxin—one for Xuzhou Tian'an and one for Xuzhou Huayu. Huaxin shall provide construction, equipment procurement, transportation, installation and adjustment, test run, construction engineering management and other necessary works to complete the Project and ensure the CDQ and CDQ WHPG systems for Tianyu meet the inspection and acceptance requirements and work normally. The project is a turn-key project and Huaxin is responsible for the quality, safety, duration and cost of the Project. The total contract price is RMB 400 million (\$66.67 million) of which RMB 200 million (\$28.83 million) is for the Xuzhou Tian'an system and RMB 200 million is for the Xuzhou Huayu system. The price is a cover-all price which includes but is not limited to all the materials, equipment, labor, transportation, electricity, water, waste disposal, machinery and safety matters. As of June 30, 2017, Zhonghong had paid \$17.71 million for the Huayu project and \$25.43 million for the Tian'an project and is committed to pay an additional \$11.81 million for the Huayu project and \$4.10 million for the Tian'an project.

#### **Item 4. Controls and Procedures.**

##### **Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures which are designed to provide reasonable assurance that information required to be disclosed in the Company's periodic SEC reports 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 its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a – 15(e) and 15d – 15(e) of the Securities Exchange Act of 1934 ("Exchange Act") at the end of the period covered by the report.

Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2017, the Company's disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in this Report was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

##### **Changes in Internal Control Over Financial Reporting**

With the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company also conducted an evaluation of the Company's internal control over financial reporting to determine whether any changes occurred during the Company's fiscal quarter ended as of June 30, 2017, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on such evaluation, management concluded that, as of the end of the period covered by this report, there have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Inherent Limitations on Effectiveness of Controls**

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on 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. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

From time to time we may be subject to litigation, claims and assessments that arise in the ordinary course of business. Litigation is subject to inherent uncertainties and an adverse result in these or other matters that may arise from time to time could have an adverse effect on our business, financial condition or operating results. 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.

### **Item 1A. Risk Factors**

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A, of our Annual Report on Form 10-K as of and for the year ended December 31, 2016. An investment in our common stock involves various risks. When considering an investment in our company, you should consider carefully all of the risk factors described in our most recent Form 10-K. If any of those risks, incorporated by reference in this Form 10-Q, occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment. These risks and uncertainties are not the only ones facing us and there may be additional matters that we are unaware of or that we currently consider immaterial. All of these could adversely affect our business, financial condition, results of operations and cash flows and, thus, the value of an investment in our company.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

### **Item 3. Defaults Upon Senior Securities**

None.



**Item 4. Mine Safety Disclosures.**

Not Applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
31.1	<u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a).</u> *
31.2	<u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a).</u> *
32.1	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350.</u> **
32.2	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350.</u> **
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*
101.DEF	XBRL Taxonomy Definitions Linkbase Document.*

\* Filed herewith

\*\*Furnished herewith

## SIGNATURES

Pursuant to the requirements 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.

CHINA RECYCLING ENERGY CORPORATION (Registrant)

Date: August 11, 2017 /s/ Guohua Ku  
Guohua Ku

Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)

Date: August 11, 2017 /s/ Binfeng Gu  
Binfeng Gu

Chief Financial Officer,  
Principal Financial Officer and Secretary

**EXHIBIT INDEX**

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