

CHINA RECYCLING ENERGY CORP
Form 10-Q
August 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
^x1934

For the quarterly period ended June 30, 2013

OR

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

For the transition period from _____ to _____

Commission File No. 000-12536

China Recycling Energy Corporation

(Exact Name of Registrant as Specified in Its Charter)

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

12/F, Tower A

Chang An International Building

No. 88 Nan Guan Zheng Jie

Xi'an City, Shaanxi Province, China

(Address of Principal Executive Offices, Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Yes No

The number of shares outstanding of the registrant's Common Stock, as of August 6, 2013 was 50,224,350.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements**CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****JUNE 30, 2013 AND DECEMBER 31, 2012**

| | 2013 (UNAUDITED) | 2012 |
|---|-----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash & equivalents | \$ 32,631,238 | \$45,004,304 |
| Restricted cash | 890,155 | 2,725,002 |
| Notes receivable | 809,232 | - |
| Accounts receivable | 65,807 | 81,819 |
| Current portion of investment in sales type leases, net | 10,785,754 | 10,389,028 |
| Interest receivable on sales type leases | 663,529 | 912,467 |
| Prepaid expenses | 50,002 | 49,581 |
| Other receivables | 173,267 | 121,109 |
| Advance to related party | 449,490 | 440,987 |
| Prepaid interest on trust loans | 830,272 | 816,164 |
| Prepaid loan fees - current | 81,714 | 81,139 |
| Total current assets | 47,430,460 | 60,621,600 |
| NON-CURRENT ASSETS | | |
| Prepaid loan fees - noncurrent | 165,911 | 202,848 |
| Investment in sales type leases, net | 143,027,721 | 118,021,435 |
| Long term investment | 647,385 | - |
| Long term deposit | 395,224 | 388,508 |
| Property and equipment, net | 67,059 | 68,305 |
| Construction in progress | 18,080,155 | 22,993,905 |
| Total non-current assets | 162,383,455 | 141,675,001 |
| TOTAL ASSETS | \$ 209,813,915 | \$202,296,601 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |

CURRENT LIABILITIES

| | | |
|--|------------|------------|
| Accounts payable | \$ 487,040 | \$ 239,722 |
| Notes payable - bank acceptances | 1,618,463 | 3,659,216 |
| Taxes payable | 1,552,456 | 1,372,535 |
| Accrued liabilities and other payables | 3,328,610 | 1,534,829 |
| Deferred tax liability | 2,682,262 | 2,471,925 |
| Bank loans payable - current | 13,271,400 | 13,523,188 |
| Trust loans payable | 31,964,653 | 31,421,526 |
| Interest payable on trust loans | 2,308,319 | 317,962 |
| Cinda note payable | 3,766,694 | 3,766,694 |
| Accrued interest on Cinda note | 180,954 | 383,929 |
| Current portion of long term payable | 1,367,192 | 1,292,185 |
| Total current liabilities | 62,528,043 | 59,983,711 |

NONCURRENT LIABILITIES

| | | |
|---|------------|------------|
| Deferred tax liability, net | 7,945,696 | 6,565,618 |
| Refundable deposit from customers for systems leasing | 841,601 | 588,656 |
| Long term payable | 3,078,793 | 3,711,658 |
| Bank loans payable | 8,092,317 | 12,091,321 |
| Total noncurrent liabilities | 19,958,407 | 22,957,253 |
| Total liabilities | 82,486,450 | 82,940,964 |

CONTINGENCIES AND COMMITMENTS

- -

STOCKHOLDERS' EQUITY

| | | |
|--|----------------|----------------|
| Common stock, \$0.001 par value; 100,000,000 shares authorized, 50,224,350 shares issued and outstanding | 50,225 | 50,225 |
| Additional paid in capital | 61,457,837 | 58,501,642 |
| Statutory reserve | 8,597,232 | 7,766,002 |
| Accumulated other comprehensive income | 13,914,760 | 11,554,225 |
| Retained earnings | 43,307,411 | 37,107,107 |
| Total Company stockholders' equity | 127,327,465 | 114,979,201 |
| Noncontrolling interest | - | 4,376,436 |
| Total equity | 127,327,465 | 119,355,637 |
| TOTAL LIABILITIES AND EQUITY | \$ 209,813,915 | \$ 202,296,601 |

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

| | SIX MONTHS ENDED JUNE 30, | | THREE MONTHS ENDED JUNE 30, | |
|---|------------------------------|--------------|--------------------------------|--------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue | | | | |
| Sales of systems | \$ 27,702,800 | \$ - | \$ 13,623,004 | \$ - |
| Contingent rental income | 550,334 | 550,973 | 289,559 | 403,420 |
| Total revenue | 28,253,134 | 550,973 | 13,912,563 | 403,420 |
| Cost of sales | | | | |
| Cost of systems | 21,402,848 | 42,951 | 10,501,936 | 28,568 |
| Total cost of sales | 21,402,848 | 42,951 | 10,501,936 | 28,568 |
| Gross profit | 6,850,286 | 508,022 | 3,410,627 | 374,852 |
| Interest income on sales-type leases | 8,553,546 | 9,527,977 | 4,728,706 | 4,713,727 |
| Total operating income | 15,403,832 | 10,035,999 | 8,139,333 | 5,088,579 |
| Operating expenses | | | | |
| General and administrative | 1,766,560 | 1,588,695 | 684,114 | 809,140 |
| Income from operations | 13,637,272 | 8,447,304 | 7,455,219 | 4,279,439 |
| Non-operating income (expenses) | | | | |
| Interest income | 153,232 | 72,311 | 60,644 | 45,405 |
| Interest expense | (2,787,689) | (5,115,547) | (1,293,193) | (2,514,313) |
| Changes in fair value of conversion feature liability | | 1,127,400 | - | - |
| Other income (expenses) | 2,873 | (93,762) | 3,853 | (1,716) |
| Total non-operating expenses, net | (2,631,584) | (4,009,598) | (1,228,696) | (2,470,624) |
| Income before income tax | 11,005,688 | 4,437,706 | 6,226,523 | 1,808,815 |
| Income tax expense | 3,726,870 | 942,081 | 2,366,816 | 454,689 |
| Income before noncontrolling interest | 7,278,818 | 3,495,625 | 3,859,707 | 1,354,126 |
| Less: Income attributable to noncontrolling interest | 247,284 | 248,938 | 126,363 | 130,004 |

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| | | | | |
|--|--------------|--------------|--------------|------------|
| Net income attributable to China Recycling Energy Corp | 7,031,534 | 3,246,687 | 3,733,344 | 1,224,122 |
| Other comprehensive items | | | | |
| Foreign currency translation gain (loss) attributable to China Recycling Energy Corp | 2,360,535 | (462,726) | 2,035,201 | (585,612) |
| Foreign currency translation gain (loss) attributable to noncontrolling interest | 78,153 | (17,956) | 66,379 | (22,975) |
| Comprehensive income attributable to China Recycling Energy Corp | \$ 9,392,069 | \$ 2,783,961 | \$ 5,768,545 | \$ 638,510 |
| Comprehensive income attributable to noncontrolling interest | \$ 325,437 | \$ 230,982 | \$ 192,742 | \$ 107,029 |
| Basic weighted average shares outstanding | 50,224,350 | 46,474,350 | 50,224,350 | 46,474,350 |
| Diluted weighted average shares outstanding * | 50,857,523 | 51,285,245 | 50,770,461 | 51,379,091 |
| Basic earnings per share | \$ 0.14 | \$ 0.07 | \$ 0.07 | \$ 0.03 |
| Diluted earnings per share * | \$ 0.14 | \$ 0.07 | \$ 0.07 | \$ 0.03 |

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

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

| | SIX MONTHS ENDED JUNE 30, | |
|---|---------------------------|--------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Income including noncontrolling interest | \$ 7,278,818 | \$ 3,495,625 |
| Adjustments to reconcile income including noncontrolling interest to net cash provided by (used in) operating activities: | | |
| Changes in sales type leases receivables | (27,702,800) | - |
| Depreciation and amortization | 23,143 | 26,518 |
| Amortization of prepaid loan fees | 40,857 | 40,429 |
| Amortization of discount related to conversion feature of convertible note | - | 1,167,300 |
| Changes in fair value of conversion feature liability | - | (1,127,400) |
| Stock options and warrants expenses | - | 112,814 |
| Changes in deferred tax | 1,419,815 | 567,071 |
| Changes in assets and liabilities: | | |
| Interest receivable on sales type leases | 262,055 | 1,698,382 |
| Collection of principal on sales type leases | 4,751,915 | 4,278,032 |
| Prepaid expenses | 433 | 60,883 |
| Accounts receivable | 17,251 | 18,954,315 |
| Other receivables | (49,562) | 407,148 |
| Construction in progress | 5,257,935 | (200,136) |
| Accounts payable | (1,842,164) | (697,805) |
| Taxes payable | 154,630 | (2,368,767) |
| Interest payable | 1,964,953 | 2,142,313 |
| Accrued liabilities and other payables | 255,153 | 295,943 |
| Accrued interest on convertible notes | (202,975) | (100,182) |
| Long term refundable deposit from customer | 240,335 | - |
| Net cash provided by (used in) operating activities | (8,130,208) | 28,752,483 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Changes in restricted cash | 1,863,073 | (679,757) |
| Acquisition of property & equipment | (20,741) | (262) |
| Long term investment | (640,892) | - |
| Net cash (provided by) used in investing activities | 1,201,440 | (680,019) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Notes receivable - bank acceptances | (801,115) | (76,101) |
| Proceeds from loans | 4,806,691 | 4,756,318 |

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| | | |
|--|---------------|---------------|
| Repayment of loans | (9,453,159) | (1,902,527) |
| Long term payable | (637,889) | (583,506) |
| Repayment of advance from related parties | - | (3,418,368) |
| Net cash used in financing activities | (6,085,472) | (1,224,184) |
| EFFECT OF EXCHANGE RATE CHANGE ON CASH & EQUIVALENTS | 641,174 | (149,031) |
| NET INCREASE (DECREASE) IN CASH & EQUIVALENTS | (12,373,066) | 26,699,249 |
| CASH & EQUIVALENTS, BEGINNING OF PERIOD | 45,004,304 | 14,949,253 |
| CASH & EQUIVALENTS, END OF PERIOD | \$ 32,631,238 | \$ 41,648,502 |
| Supplemental Cash flow data: | | |
| Income tax paid | \$ 2,203,339 | \$ 2,700,191 |
| Interest paid | \$ 1,518,052 | \$ 1,887,443 |

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CHINA RECYCLING ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013 (UNAUDITED) AND DECEMBER 31, 2012

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

China Recycling Energy Corporation (the “Company” or “CREG”) was incorporated on May 8, 1980, under the laws of the State of Colorado. On September 6, 2001, the Company re-domiciled its state of incorporation to Nevada. The Company, through its subsidiaries, Shanghai TCH Energy Technology Co., Ltd (“Shanghai TCH”), Xi’an TCH Energy Technology Co., Ltd (Xi’an TCH) and Huahong New Energy Technology Co, Ltd (Huahong), provides energy saving solution and services, including selling and leasing energy saving systems and equipment to customers. On March 8, 2007, the Company changed its name to “China Recycling Energy Corporation” from “China Digital Wireless, Inc.”

On April 14, 2009, the Company incorporated a joint venture (the “JV”) with Erdos Metallurgy Co., Ltd. (the “Erdos”) to recycle waste heat from Erdos’ metal refining plants to generate power and steam, which will then be sold back to Erdos. The name of the JV is Inner Mongolia Erdos TCH Energy Saving Development Co., Ltd (the “Erdos TCH”) with a term of 20 years. Total investment for the project is estimated at \$79 million (RMB 500 million) with an initial investment of \$17.55 million (RMB 120 million). As of June 30, 2013, Erdos had contributed 7% of the total investment of the project, and Xi’an TCH had contributed 93%. According to Xi’an TCH and Erdos’ agreement on profit distribution, Xi’an TCH and Erdos will receive 80% and 20% of the profit from the JV, respectively, until Xi’an TCH receives the complete return of its investment. Xi’an TCH and Erdos will then receive 60% and 40% of the profit from the JV, respectively. When the JV expires, Xi’an TCH will transfer its equity in the JV to Erdos at no cost. On June 15, 2013, Xi’an TCH and Erdos Metallurgy entered into a share transfer agreement; Erdos Metallurgy transferred its entire 7% share in Erdos TCH, to Xi’an TCH at a cost of \$1.29 million (RMB 8 million). Xi’an TCH paid this amount in July 2013 and became the 100% shareholder of Erdos TCH. In addition, Xi’an TCH is required to pay Erdos Metallurgy the amount of accumulated profits from inception up to the transfer date the amount of which is \$227,901. Since there were no material transactions from June 15, 2013 to June 30, 2013, Xian TCH and Erdos Metallurgy entered into profit allocation supplementary agreement to allocate profits to Erdos Metallurgy up to and for the period ended June 30, 2013.

On May 25, 2011, Xi’an TCH entered into a Letter of Intent with Shenqiu YuNeng Thermal Power Co., Ltd. (“Shenqiu”) for Xi’an TCH to reconstruct and transform a Thermal Power Generation System owned by Shenqiu into a 75T/H Biomass Power Generation System for \$3.5 million (RMB 22.5 million). On September 28, 2011, Xi’an TCH entered into a Biomass Power Generation Asset Transfer Agreement with Shenqiu. Per the Transfer Agreement, Shenqiu sold to Xi’an TCH a set of 12MW biomass power generation systems. On September 28, 2011, Xi’an TCH and Shenqiu also entered into a Biomass Power Generation Project Lease Agreement (the “Lease Agreement”). Under the Lease Agreement, Xi’an TCH agreed to lease the set of 12MW biomass power generation systems to Shenqiu for \$286,000 (RMB 1,800,000) per month for 11 years. Upon completion of the Lease Agreement, ownership of this system will be

transferred from Xi'an TCH to Shenqiu at no cost.

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 technical reformation involved the construction of another 12MW biomass power generation system. After the reformation, the generation capacity of the power plant increased to 24MW. The project commenced on October 25, 2012 and was completed during the first quarter of 2013. The total cost of the project was \$10.83 million (RMB 68 million). On March 30, 2013, Xi'an TCH and Shenqiu also entered into a Biomass Power Generation Project Lease Agreement (the "Lease Agreement"). Under the Lease Agreement, Xi'an TCH leased the second set of 12MW biomass power generation systems to Shenqiu for \$239,000 (RMB 1.5 million) per month for 9.5 years. Upon completion of the Lease Agreement, ownership of this system will be transferred from Xi'an TCH to Shenqiu at no cost.

In February 2011, Xi'an TCH signed a contract with Shanxi Datong Coal Group Steel Co., Ltd ("Datong") for constructing a series of systems for power generation from recycled gas and steam from groups of blast furnaces. According to the contract, Xi'an TCH will build and install two 3MW BPRT, one 15MW WGPG and two 1MW steam power generation systems, with a total of 23MW power capacity for an estimated total investment of \$27.45 million (RMB 180 million). In June 2013, the two 3 MW BPRT power generation systems were completed. The total cost of the project was \$10.84 million (RMB 65 million). The lease term is 30 years. During the term of the lease, Shanxi Datong will pay a service fee to Xi'an TCH based on actual electricity generated and Xi'an TCH will be responsible for operating the systems. On June 10, 2013, Xi'an TCH and Shanxi Datong entered into a supplemental agreement for the minimum service fee, the minimum service fee per month for the first five years is \$0.19 million (RMB 1.2 million), \$0.18 million (\$1.1 million) for the second five years, \$0.16 (RMB 1.0 million) for the following 10 years and \$0.15 million (RMB 0.9 million) for the last 10 years. After 30 years, the units will be transferred to Shanxi Datong without any charge.

In May 2013, Xi'an TCH signed a contract with Sinosteel Jilin Ferroalloys Co., Ltd. ("Jitie") to build furnace gas waste heat power generation systems for electricity generation from recycled heat and steam from groups of ferroalloy furnaces and electric furnaces ("Jitie project"). According to the contract, Xi'an TCH will install a 7.5 MW and a 3 MW turbine power generation system with a total of 10.5 MW power capacity for an estimated total investment of \$9.71 million (RMB 60 million). The lease term is 24 years. During the term of the lease, Jitie will pay a service fee to Xi'an TCH based on the actual generating capacity with a minimum service fee per month of \$0.3 million (RMB 1.8 million). Xi'an TCH will be responsible for the systems operation and will own the power generation systems. On May 12, 2013, Xi'an TCH entered into an agreement with Xi'an Huaxin Energy Tech Co., Ltd (the contractor for construction) for the construction of Jitie projects. The project is scheduled to be completed 12 months from construction commencement.

On June 25, 2013, the Company's subsidiary, Xi'an TCH, with Hongyuan Huifu Venture Capital Co. Ltd ("Hongyuan Huifu") jointly established Hongyuan Recycling Energy Investment Management Beijing Co., Ltd ("Fund Management Company"), with registered capital of RMB 10 million, to manage a fund Beijing Hongyuan Recycling Energy Investment Center, LLP ("HYREF Fund") that will be used for financing a coke dry quenching ("CDQ") waste heat power generation project (See note 10). Xi'an TCH paid RMB 4 million (\$0.65 million) and owns 40% of Fund Management Company. An initial amount of RMB 460 million (\$74 million) for HYREF Fund has been fully subscribed.

As of June 30, 2013, we have one TRT system, two CHPG systems, five recycling waste heat power generating systems from the Erdos projects, three BMPG systems, one WHPG system of Zhongbao, and two BPRT system of Shanxi Datong are under sales-type leases.

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 2012 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, 2013 are not necessarily indicative of the results expected for the full year ending December 31, 2013.

Basis of Consolidation

The consolidated financial statements include the accounts of CREG and, its subsidiary, Sifang Holdings, its wholly owned subsidiaries, Huahong New Energy Technology Co., Ltd. (“Huahong”) and Shanghai TCH, Shanghai TCH’s subsidiary Xi’an TCH Energy Tech Co., Ltd. (“Xi’an TCH”) and Erdos TCH Energy Saving Development Co., Ltd (“Erdos TCH”), 100% owned by Xi’an TCH as of June 15, 2013 (See note 1). 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, 2013 and December 31, 2012, respectively. All significant inter-company accounts and transactions were eliminated in consolidation.

Use of Estimates

In preparing these consolidated financial statements 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 our customers. The Company usually 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 Statement of Financial Accounting Standards (“SFAS”) No. 13, “Accounting for Leases” (codified in Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 840) and its various amendments and interpretations. The Company finances construction of waste energy recycling power generating. The sales and cost of sales are recognized at the inception of 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 (lessor) and the customer (lessee). The discount rate implicit in the lease is used to calculate the present value of minimum lease payments. The minimum lease payment consists 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, 2013 and December 31, 2012, the Company had accounts receivable of \$65,807 and \$81,819 respectively, from contingent rental income.

Property and Equipment

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

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

Impairment of Long-life Assets

In accordance with SFAS 144 (codified in FASB ASC Topic 360), the Company reviews its long-lived assets, including property, plant and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. If the total expected undiscounted future net cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and carrying amount of the asset. There was no impairment as of June 30, 2013 and December 31, 2012.

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.

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.

ASC Topic 820, "Fair Value Measurements and Disclosures," requires disclosure of the fair value ("FV") of financial instruments held by the Company. 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 the 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.

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

As of June 30, 2013, the Company's long term debt obligations consisted of the following: (i) bank loans payable of \$8.09 million, (ii) a long term payable for a sale-leaseback transaction of \$3.08 million. As of December 31, 2012, the Company's long term debt obligations consisted of the following: (i) bank loans payable of \$12.09 million, (ii) a long

term payable for a sale-leaseback transaction of \$3.71 million.

FV measurements / 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 each of the Company's long term debt obligations noted above, the Company believes the carrying amounts approximate their FV. The following reasons support this determination.

Bank Loans Payables of \$8.09 Million (noncurrent portion)

As of June 30, 2013, the Company had two loans with the same Chinese commercial bank with terms of three and four years, respectively. Each loan was for the subsidiary's (Xi'an TCH's) energy saving and emission reduction projects and had a floating interest rate that both reset at the beginning of each quarter at 115%, of the national base interest rate for the same term and same level loan. Each of these loans was guaranteed by Xi'an TCH (along with a pledge of its accounts receivables) and by certain executive officers of the Company, and a pledge of certain BMPG (Biomass Power Generation) systems. 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.

Sale-Leaseback Transaction of \$3.08 Million (Long Term Payable)

The Company recorded the sale-lease back transaction at FV, which is the present value of the total future cash outflow including principal and interest payments.

As of June 30, 2013 and December 31, 2012, the Company did not identify any assets and liabilities that are required to be presented on the balance sheet at FV other than the sale-lease back transaction of \$3.08 million described above.

Basic and Diluted Earnings per Share

The Company presents net income (loss) per share (“EPS”) in accordance with SFAS No. 128, “Earnings per Share” (codified in FASB ASC Topic 740). Accordingly, basic income (loss) per share is computed by dividing income (loss) available to common shareholders 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:

The following table presents a reconciliation of basic and diluted earnings per share for the six and three months ended June 30, 2013 and 2012:

| | Six Months Ended | | Three Months Ended | |
|---|------------------|-------------|--------------------|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income for common shares | \$7,031,534 | \$3,246,687 | \$3,733,344 | \$1,224,122 |
| Interest expense on convertible notes* | - | 502,487 | - | 264,125 |
| Net income for diluted shares | \$7,031,534 | \$3,749,174 | \$3,733,344 | \$1,488,247 |
| Weighted average shares outstanding – basic | 50,224,350 | 46,474,350 | 50,224,350 | 46,474,350 |
| Effect of dilutive securities: | | | | |
| Convertible notes | - | 3,810,000 | - | 3,810,000 |
| Options granted | 633,173 | 1,000,895 | 546,111 | 1,094,741 |
| Weighted average shares outstanding – diluted | 50,857,523 | 51,285,245 | 50,770,461 | 51,379,091 |

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| | | | | |
|------------------------------|--------|--------|--------|--------|
| Earnings per share – basic | \$0.14 | \$0.07 | \$0.07 | \$0.03 |
| Earnings per share – diluted | \$0.14 | \$0.07 | \$0.07 | \$0.03 |

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

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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 uses SFAS 130 "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.

New Accounting Pronouncements

In February 2013, the FASB issued ASU 2013-2, Comprehensive Income (ASC Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, the new ASU requires entities to disclose in a single location (either on the face of the financial statement that reports net income or in the notes) the effects of reclassifications out of accumulated other comprehensive income (AOCI). For items reclassified out of AOCI and into net income in their entirety, entities must disclose the effect of the reclassification on each affected net income item. For AOCI reclassification items that are not reclassified in their entirety into net income, entities must provide a cross-reference to other required U.S. GAAP disclosures. There is no change in the requirement to present the components of net income and other comprehensive income in either a single continuous statement or two separate consecutive statements. The ASU does not change the items currently reported in other comprehensive income.

For public entities, the new disclosure requirements are effective for annual reporting periods beginning after December 15, 2012, and interim periods within those years (i.e., the second quarter of 2013 for entities with calendar year-ends). The ASU applies prospectively, and early adoption is permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

As of June 30, 2013, there are no recently issued accounting standards not yet adopted that would have a material effect on the Company's interim consolidated financial statements.

3. NET INVESTMENT IN SALES-TYPE LEASES

Under sales-type leases, Xi'an TCH leased TRT systems to Zhangzhi with terms of 5 and 13 years, respectively; and leased CHPG systems to Tong Chuan, Shengwei, and Jing Yang Shengwei respectively for 5 years, BMPG systems to Pucheng for 15 years, BMPG systems to Shenqiu Phase I for 11 years, Shenqiu Phase II for 9.5 years, a power and steam generating system from waste heat from metal refining to Erdos (five projects) for 20 years, and Datong two BPRT systems for 30 years. The components of the net investment in sales-type leases as of June 30, 2013 and December 31, 2012 are as follows:

| | 2013 | 2012 |
|--|---------------|---------------|
| Total future minimum lease payments receivable | \$451,595,852 | \$380,608,263 |
| Less: executory cost | (123,200,558) | (113,529,216) |
| Less: unearned interest income | (174,581,819) | (138,668,584) |
| Net investment in sales - type leases | 153,813,475 | 128,410,463 |
| Current portion | 10,785,754 | 10,389,028 |
| Noncurrent portion | \$143,027,721 | \$118,021,435 |

As of June 30, 2013, the future minimum rentals to be received on non-cancelable sales-type leases by years are as follows:

| | |
|------------|---------------|
| 2014 | \$39,630,307 |
| 2015 | 31,985,296 |
| 2016 | 31,952,927 |
| 2017 | 31,952,927 |
| 2018 | 31,952,927 |
| Thereafter | 284,121,468 |
| Total | \$451,595,852 |

4. RESTRICTED CASH, NOTES PAYABLE – BANK ACCEPTANCES

Restricted cash as of June 30, 2013 and December 31, 2012 was \$890,155 and \$2,725,002 (of which, \$954,578 was deposited as a principal-guaranteed financial investment product with a term of six months at December 31, 2012), respectively, held by the bank as collateral to issue bank acceptances. The Company endorses bank acceptances to vendors as payment of its own obligations. Most of the bank acceptances have maturities of less than six months.

5. PREPAID EXPENSES

Prepaid expenses mainly consisted of prepayment for supplies, office rental, parking space, insurance and legal fees.

6. CONSTRUCTION IN PROGRESS

Construction in progress was for constructing power generation systems. As of June 30, 2013, the Company had construction in progress of \$18.08 million, including \$13.22 million for the Shanxi Datong Coal Group Power Generation project and \$ 4.86 million for Jitie project. The two 3 MW BPRT systems of Shanxi Datong project were completed and sold in the second quarter of 2013. As of December 31, 2012, the Company had construction in progress of \$19.27 million for the Shanxi Datong Coal Group Power Generation project and \$3.72 million for the Shenqiu Project Phase II. Shenqiu Project Phase II was completed at the end of March 2013. As of June 30, 2013, the Company was committed to pay an additional \$5.50 million for the Shanxi Datong Coal Group Power Generation project and \$4.86 million for Jitie project.

7. TAXES PAYABLE

Taxes payable consisted of the following as of June 30, 2013 and December 31, 2012:

| | 2013 | 2012 |
|--|-------------|-------------|
| Income | \$837,697 | \$689,532 |
| Business | 287,905 | 257,378 |
| VAT arising from transfer WPGG to Shenmu | 388,431 | 381,832 |
| Other | 38,423 | 34,793 |
| | \$1,552,456 | \$1,372,535 |

8. ACCRUED LIABILITIES AND OTHER PAYABLES

Accrued liabilities and other payables consisted of the following as of June 30, 2013 and December 31, 2012:

| | 2013 | 2012 |
|--|-------------|-------------|
| Employee training, labor union expenditure and social insurance payable | \$378,960 | \$372,521 |
| Consulting, auditing, and legal expenses | 688,957 | 618,957 |
| Accrued payroll and welfare | 373,718 | 291,310 |
| Accrued system maintenance expense | 48,554 | 47,729 |
| Payable to Erdos for purchasing the minority share of Erdos TCH (See note 1) | 1,522,672 | - |
| Other | 315,749 | 204,312 |
| Total | \$3,328,610 | \$1,534,829 |

9. RELATED PARTY TRANSACTIONS

As of June 30, 2013, advances to related parties totaled \$449,490, including \$490,192 to Erdos Metallurgy (the minority shareholder of Erdos TCH), as a receivable for maintenance fee and tax expense, but net of \$40,702 in advances from the Company's management, which bore no interest, and are payable on demand.

As of December 31, 2012, advances to related parties totaled \$440,987, including \$481,863 to Erdos Metallurgy (the minority shareholder of Erdos TCH), as a receivable for maintenance fee and tax expense, but net of a \$40,876 in advances from the Company's management, which bore no interest, and were payable on demand.

Erdos TCH sold all power generation stations through sales type leases to Erdos Metallurgy Co., Ltd., the non-controlling interest holder (Erdos Metallurgy sold all its ownership shares in Erdos TCH to Xi'an TCH on June 15, 2013). Total sales and interest income for this non-controlling interest was \$0.30 million and \$3.68 million for the six months ended June 30, 2013, and \$0.38 million and \$3.70 million for the six months ended June 30, 2012; \$0.1 million and \$1.85 million for the three months ended June 30, 2013, and \$0.28 million and \$1.84 million for the corresponding 2012 period.

As of June 30, 2013, Xian TCH purchased Erdos Metallurgy's minority interest in Erdos TCH, as a result Erdos Metallurgy is not a related party (See note 1).

10. LONG TERM INVESTMENT

On June 25, 2013 the Company with Hongyuan Huifu Venture Capital Co. Ltd ("Hongyuan Huifu") jointly established Hongyuan Recycling Energy Investment Management Co., Ltd ("Hongyuan Management") with registered capital of RMB 10 million (\$1.6 million), to manage a fund that will be used for financing a coke dry quenching ("CDQ") waste heat power generation project. As of June 30, 2013, the Company has invested \$0.65 million (RMB 4 million) for 40% ownership of Hongyuan Management. The Company and Hongyuan Huifu are currently in the process of drafting the financing terms.

11. NONCONTROLLING INTEREST

“Non-controlling interest” was a 7% equity interest of Erdos TCH owned by Erdos Metallurgy Co., Ltd. According to Xi’an TCH and Erdos’ agreement on profit distribution, Xi’an TCH and Erdos would receive 80% and 20% of the profit from the JV, respectively, until Xi’an TCH has received the complete return of its investment. Xi’an TCH and Erdos would then receive 60% and 40% of the profit from the JV, respectively.

As of June 15, 2013, the total registered capital of Erdos TCH was \$17.55 million (RMB 120,000,000), of which, \$16.37 million (RMB 112 million) was contributed by Xi’an TCH, and \$1.18 million (RMB 8 million) was from Erdos. Erdos TCH engages in a business similar to that of Xi’an TCH. On June 15, 2013, Xi’an and Erdos Metallurgy entered into a share purchase agreement. Xi’an will pay Erdos Metallurgy \$1.29 million (RMB 8 million) for the 7% equity interest of Erdos TCH and then become 100% owner of Erdos TCH. In addition, Erdos TCH will distribute 20% of the accumulated profit (calculated under PRC GAAP) to Erdos Metallurgy. For convenience of reporting, June 30, 2013 was designated as the ownership transfer date. In July 2013, Xi’an paid \$1.29 million (RMB 8 million) to Erdos Metallurgy, and had outstanding \$227,901 accumulated profits to be paid to the minority interest..

Erdos TCH allocated its income to Xi’an TCH and Erdos at a proportion of 80% and 20% based on net income calculated under PRC GAAP. The main difference between US GAAP and PRC GAAP with respect to Erdos TCH is that the Erdos agreement is treated as a sales-type lease under US GAAP and as an operating lease under PRC GAAP. The following is an unaudited profit and loss statement of Erdos TCH, prepared under PRC GAAP for the six months ended June 30, 2013 and 2012 (note: Erdos TCH’s US GAAP basis financial statements are part of the Company’s consolidated financial statements discussed in Note 2 – Basis for Consolidation):

| | 2013 | 2012 |
|------------------------------|-------------|-------------|
| Net Revenue | \$7,512,597 | \$7,510,614 |
| Cost of Revenue | 4,256,260 | 4,215,028 |
| Gross Profit | 3,256,337 | 3,295,586 |
| Operating expenses | 58,517 | 28,075 |
| Income from operations | 3,197,820 | 3,267,511 |
| Non-operating income expense | (2,187,350) | (2,361,930) |
| Income tax expense | (252,617) | (226,395) |
| Net Income | \$757,853 | \$679,186 |

The following is a reconciliation of net income (loss) per Chinese GAAP to net income per US GAAP for the six months ended June 30, 2013 and 2012:

| | 2013 | 2012 |
|------------------------------|-------------|-------------|
| Net income per Chinese GAAP | \$757,853 | \$679,186 |
| Adjustments under US GAAP: | | |
| Revenue per sales-type lease | (7,210,036) | (7,134,477) |
| Cost of revenue | 4,185,610 | 4,190,397 |
| Loss from operation | (3,024,426) | (2,944,080) |
| Operating income (loss) | (69) | - |
| Interest income | 3,678,975 | 3,703,026 |
| Income before income tax | 654,480 | 758,946 |
| Deferred income tax expense | (175,912) | (193,443) |
| Net adjustment | 478,568 | 565,503 |
| Net income per US GAAP | \$1,236,421 | \$1,244,689 |

The following is an unaudited balance sheet of Erdos TCH, prepared under PRC GAAP as of June 30, 2013 and December 31, 2012:

| | 2013 | 2012 |
|---------------------------|--------------|--------------|
| Assets | | |
| Cash and equivalents | \$11,851 | \$12,411 |
| Other current assets | 17,352,763 | 12,774,129 |
| Property and equipment | 46,073,830 | 46,558,041 |
| Total Assets | \$63,438,444 | \$59,344,581 |
| Liabilities | | |
| Accounts payable | \$113,697 | \$39,774 |
| Other current liabilities | 2,612,474 | 376,649 |
| Long term loan | 39,450,046 | 38,779,731 |
| Total liabilities | 42,176,217 | 39,196,154 |
| Equity | | |
| Paid in capital | 17,573,578 | 17,573,578 |

| | | |
|--|--------------|--------------|
| Statutory reserve | 570,094 | 570,094 |
| Other comprehensive income | 2,109,907 | 1,753,959 |
| Retained earnings | 1,008,648 | 250,796 |
| Total stockholders' equity | 21,262,227 | 20,148,427 |
| Total liabilities and stockholders' equity | \$63,438,444 | \$59,344,581 |

12. DEFERRED TAX

Deferred tax asset resulted from accrued maintenance cost on power generation systems that can be deducted for tax purposes in the future; and 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, 2013 and December 31, 2012, deferred tax liability consisted of the following:

| | 2013 | 2012 |
|---|----------------|----------------|
| Deferred tax asset — noncurrent (accrual of system maintenance cost) | \$82,150 | \$48,453 |
| Deferred tax asset — noncurrent (depreciation of fixed assets) | 27,782,898 | 22,933,886 |
| Deferred tax liability — noncurrent (net investment in sales-type leases) | (35,810,744) | (29,547,957) |
| Deferred tax liability, net of deferred tax asset – noncurrent | \$(7,945,696) | \$(6,565,618) |
| Deferred tax liability — current (net investment in sales-type leases) | \$(2,682,262) | \$(2,471,925) |

13. 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 net income from their PRC operations. Shanghai TCH's effective income tax rate for 2013 and 2012 is 25%. Xi'an TCH's effective income tax rate in 2012 until August was 15% as a result of its high tech enterprise status that was approved by the taxing authority. The 15% rate expired in August 2012, and Xi'an TCH's effective income tax rate became 25%. Huahong and Erdos TCH's effective income tax rate for 2013 and 2012 was 25%. Shanghai TCH, Xi'an TCH, Huahong, and Erdos TCH file separate income tax returns.

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

The parent company, China Recycling Energy Corporation, is taxed in the U.S. and, as of June 30, 2013, had net operating loss ("NOL") carry forwards for income taxes of \$11.4 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 Company's limited operating history and continuing operating losses. Accordingly, a 100% deferred tax asset valuation allowance was provided.

As of June 30, 2013, a total of \$77.2 million, of our non-US subsidiaries' accumulated undistributed earnings, has been indefinitely invested. At the existing U.S. federal income tax rate, additional taxes of approximately \$14.1 million

would have been owed if such earnings were currently remitted.

The following table reconciles the U.S. statutory rates to the Company's effective tax rate for six and three months ended June 30, 2013 and 2012, respectively:

| | Six Months | | Three Months | |
|---|------------|---------|--------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| U.S. statutory rates | 34.0% | 34.0 % | 34.0% | 34.0 % |
| Tax rate difference – current provision | (9.9)% | (11.8)% | (9.5)% | (15.5)% |
| Effective tax holiday | - % | (9.4)% | - % | (12.5)% |
| Non tax-deductible expense | - % | 0.3 % | - % | 11.0 % |
| Effect of tax rate change on deferred tax items | 6.3 % | - % | 11.5% | - % |
| Valuation allowance on US NOL | 3.5 % | 8.1 % | 2.0 % | 8.1 % |
| Tax per financial statements | 33.9% | 21.2 % | 38.0% | 25.1 % |

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Non-tax deductible expenses represented permanent non-tax deductible interest expense resulting from an amortization of a beneficial conversion feature for a convertible note and changes in FV of conversion feature liability.

The provision for income taxes expense for the six and three months ended June 30, 2013 and 2012 consisted of the following:

| | Six Months | | Three Months | |
|---------------------------------------|-------------|-----------|--------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Income tax expense – current | \$2,307,055 | \$375,010 | \$1,698,403 | \$176,787 |
| Income tax expense benefit - deferred | 1,419,815 | 567,071 | 668,413 | 277,902 |
| Total income tax expense | \$3,726,870 | \$942,081 | \$2,366,816 | \$454,689 |

14. LOANS PAYABLE

Collective Capital Trust Plan

On December 3, 2009, the Company and Beijing International Trust Co., Ltd. (“Beijing Trust”) formed a Low Carbon Fortune-Energy Recycling No. 1 Collective Capital Trust Plan (“Plan”) pursuant to the Capital Trust Loan Agreement (the “Agreement”) entered into by Erdos TCH Energy Saving Development Co., Ltd and Beijing Trust dated November 19, 2009. All amounts raised under the Plan were loaned to Erdos TCH in connection with its waste heat power generation projects Phase II and Phase III construction and operation.

Under the Agreement, the annual base interest rate was 9.94% for A1 preferred trust fund units with a term of two years, 11% for A2 preferred trust fund units with a term of three years, 12.05% for A3 preferred trust fund units and 8.35% for the category B secondary trust fund units, each with a term of four years. Erdos TCH provided a lien on its equipment, assets and accounts receivable to guarantee the loans under the Agreement. Xi’an TCH and Mr. Guohua Ku, the CEO, the Chairman of the Company’s Board of Directors and a major shareholder, provided unconditional and irrevocable joint liability guarantees to Beijing Trust for Erdos TCH’s performance under the Agreement. Erdos (the minority shareholder and customer of Erdos TCH) provided a commitment letter on minimum power purchase from Erdos TCH.

The Trust Plan raised \$44.1 million (RMB 300,000,000) through a series of capital raises in 2009 and 2010, of which, 13,750,000 B1 units (\$2.0 million) were purchased by the management of Erdos TCH; 1,600,000 (\$235,600) A1 units and 46,250,000 B2 units (\$7.4 million) were purchased by Xi’an TCH, the amount was considered an investment by

Xi'an TCH into Erdos TCH and, accordingly, was eliminated in the consolidated financial statements. Portion of category A units (RMB 35,250,000) were due and paid in full on December 3, 2011, of which, RMB 1,600,000 was purchased by Xi'an TCH. As of December 31, 2012, the entire outstanding trust loan was due within one year. The net loan payable under this trust plan was \$31.9 million and \$31.4 million (RMB 197,500,000) as of June 30, 2013 and December 31, 2012, respectively.

In addition to the above, under the Loan Agreement, Erdos TCH must pay a management incentive benefit to Beijing Trust upon maturity of the category A3 and category B trust units in December 2013 if the ratio of Erdos TCH's profit to its registered capital exceeds a base amount. If this criterion is met, the amount of the management incentive benefit is calculated based on a formula tied to Erdos TCH's net profit and the average registered capital for the 2012 fiscal year. Under this formula the management incentive benefit could range between 0% and 100% of the net profit of Erdos TCH in the 2012 fiscal year. For the year ended December 31, 2012, Erdos TCH incurred a net loss under both PRC GAAP and US GAAP.

The management incentive benefit was structured to provide an incentive to management to make the joint venture profitable. Under the Plan, Beijing Trust will distribute the entire amount of the management incentive benefit it receives to the holders of the category B trust units. As previously disclosed, the holders of the category B trust units are the management of Erdos TCH and Xi'an TCH. Category B trust units receive a lower base interest rate than the category A trust units but the economic return to the holders of category B trust units will be enhanced by any management incentive benefit.

Erdos TCH also will share the benefits from Clean Development Mechanism ("CDM") under the Kyoto Protocol equally with Beijing Trust during the term of the loan. Any benefit received from CDM will be paid to Erdos Metallurgy first. Under the agreement with Xi'an TCH, Erdos Metallurgy agrees to deliver to Xi'an TCH 50% of the benefit Erdos Metallurgy receives. Xi'an TCH agrees to share 50% of the benefit it receives from Erdos Metallurgy with Erdos TCH. Under the Capital Trust Loan Agreement between Erdos TCH and Beijing Trust, Erdos TCH agrees that 50% of any benefit it receives will be delivered to Beijing Trust. Pursuant to the Plan, Beijing Trust will distribute 70% of the CDM benefit it receives to the holders of the category B trust units. The receipt of any CDM benefit is subject to a process of evaluation and certification of the project by the CDM Executive Board and is under the guidance of the Conference of the Parties of the United Nations Framework Convention on Climate Change. The first stages of the certification process have been completed successfully.

Bank Loans - Industrial Bank

Xi'an TCH entered into an agreement with Industrial Bank Co., Ltd., Xi'an Branch (the "Lender") for a loan designed for energy saving and emission reduction projects, whereby the Lender agreed to loan \$4.86 million (RMB 30,000,000) to Xi'an TCH for three years from April 6, 2010 to April 5, 2013. The loan had a floating interest rate that reset at the beginning of each quarter at 110% of the national base interest rate for the same term and same level loan (then 6.77%). The loan agreement contained standard representations, warranties and covenants, and was guaranteed by Xi'an TCH, Shaanxi Shengwei Construction Material Group and Mr. Guohua Ku. The principal was paid in full at maturity.

Xi'an TCH entered into another loan agreement with the same Industrial Bank for energy saving and emission reduction projects, whereby the Lender agreed to loan \$4.86 million (RMB 30,000,000) to Xi'an TCH for three years to March 30, 2014. The loan agreement has a floating interest rate that resets at the beginning of each quarter at 115% of the national base interest rate for the same term and same level loan (then 7.07%). Under the loan, Xi'an TCH is required to make quarterly interest payments and, beginning six months after the date of the release of the funds, to make minimum quarterly principal payments of \$486,000 (RMB 3,000,000). The loan agreement contains standard representations, warranties and covenants, and the loan is guaranteed by Xi'an TCH, Mr. Guohua Ku and Ms. Chaoying Zhang. As of June 30, 2013, this loan had an outstanding balance of \$1.94 million, which is to be repaid within one year.

The loan was originally pledged with the system and revenue of the project ZhongBao. In June 2011, the system of the project ZhongBao was sold to and leased back from Cinda Financial Leasing Co., Ltd. (the "Cinda Financial"), the Company engaged a third party guarantee company as the guarantor for the loan, which was approved by the Industrial Bank in July 1, 2011. The loan had the following covenants: (i) maintain the current assets and net assets not less than \$79 million (RMB 500 million); (ii) assets to liability ratio not less than 80%; and (iii) the current ratio not less than 1. In the first quarter of 2011, the Company received a waiver letter from the Lender waiving all covenants.

On November 8, 2011, Xi'an TCH entered the third loan agreement with the same Industrial Bank for energy saving and emission reduction projects, whereby the Lender agreed to loan \$21.04 million (RMB 130,000,000) to Xi'an TCH for four years to November 27, 2015. The loan agreement has a floating interest rate that resets at the beginning of each quarter at 115% of the national base interest rate for the same term and same level loan (then 7.36%). Under the loan, Xi'an TCH is required to make quarterly interest payments and, beginning nine months after the date of the release of the funds, to make minimum quarterly principal payments of \$1,618,463 (RMB 10,000,000). For the first nine months, the loan was in a grace period and there was no repayment requirement. The loan is guaranteed by accounts receivable of Xi'an TCH, Pucheng and Shenqiu BMPG systems and Mr. Guohua Ku. As of June 30, 2013, this loan had outstanding balance of \$14.57 million, of which, \$6.47 million was to be repaid within one year and was classified as current liability, and \$8.10 million will be repaid after one year and was classified as noncurrent liability.

Bank Loan – Bank of Xi’an

During the first quarter of 2012, Xi’an TCH entered into an agreement with Bank of Xi’an, whereby Bank of Xi’an agreed to loan \$4.86 million (RMB 30,000,000) to Xi’an TCH for one year with maturity on March 1, 2013. The monthly interest rate of the loan was 0.60133%. 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 Mr. Guohua Ku. The Company paid the third party guarantee company \$119,322 (RMB 750,000) as a re-guarantee service fee. This loan was repaid at maturity.

On March 28, 2013, Xi’an TCH entered into another agreement with Bank of Xi’an, whereby Bank of Xi’an agreed to loan \$4.86 million (RMB 30,000,000) to Xi’an TCH for one year with maturity on March 27, 2014. The monthly interest rate of the loan is 0.575%. Under the terms of the loan, Xi’an TCH is required to make monthly interest payments and the principal is to be repaid at maturity. The loan is guaranteed by a third party guarantee company and Mr. Guohua Ku. The Company paid a third party \$115,315 (RMB 712,500) as a re-guarantee service fee.

As of June 30, 2013, the future minimum repayment of all the bank loans to be made by years was as follows:

| | |
|-------|--------------|
| 2014 | \$13,271,400 |
| 2015 | 6,473,854 |
| 2016 | 1,618,463 |
| Total | \$21,363,717 |

Financing Agreement- - Sale Lease-Back Transaction (Long Term Payable)

On June 28, 2011, Xi’an TCH entered into a Financing Agreement (the “Agreement”) with Cinda Financial Leasing Co., Ltd. (the “Cinda Financial”), an affiliate of China Cinda (HK) Asset Management Co., Ltd. (the “Cinda HK”).

Under the Agreement, Xi’an TCH transferred its ownership of a set of 7MW steam turbine waste heat power generation system (the “WHPG system currently used by Zhongbao”) and four furnaces and ancillary apparatus (the “Assets”) to Cinda Financial for \$6.72 million (RMB 42.50 million), and Cinda Financial leased the Assets to Xi’an TCH for 5 years for \$8.15 million (RMB 51.54 million) based upon the transfer cost and the benchmark interest rate for five year loans by People’s Bank of China (“PBOC”) (then 6.65%) plus 15% of that rate (7.6475%). The interest rate will increase if the five-year benchmark interest rate of PBOC increases but will remain the same if the benchmark rate decreases in the future. Xi’an TCH shall make pro rata quarterly payments to Cinda Financial for the leasing fees. Upon the completion of the lease term and full payment of all leasing fees and other fees, Xi’an TCH can pay \$676

(RMB 4,250) to acquire the ownership of the Assets from Cinda Financial. The quarterly minimum leasing payment to Cinda Financial is \$412,855 (RMB 2,594,998).

In addition to the leasing fees, Xi'an TCH prepaid a one-time non-refundable leasing service charge of \$405,696 (RMB 2,550,000) and a refundable security deposit of \$338,079 (RMB 2,125,000) to Cinda Financial. The prepaid leasing service fee is to be: amortized over five years. For the six months ended June 30, 2013 and 2012, \$40,857 (RMB 255,000) and \$40,429 (RMB 255,000) was amortized; and \$20,550 and \$20,215 was amortized for the three months ended June 30, 2013 and 2012, respectively. The unamortized portion was recorded as prepaid loan fees of \$81,714 and \$165,911 into current and non-current portions, respectively, as of June 30, 2013.

In accordance with ASC 840-10-25-4, since CREG retains substantially all of the benefits and risks relating to the property, this transaction was a financing and was recorded as such. The proceeds of this financing were not received prior to June 30, 2011; therefore, this transaction was recorded in the third quarter of 2011. As of June 30, 2013, the Company made repayments of \$3,359,622 to Cinda Financial.

As of June 30, 2013, the future minimum payment to be made by years was as follows:

| | |
|-------------------------|-------------|
| 2014 | \$1,679,964 |
| 2015 | 1,679,964 |
| 2016 | 1,679,964 |
| Total | 5,039,892 |
| Unamortized interest | (593,907) |
| Total long term payable | 4,445,985 |
| Current portion | 1,367,192 |
| Noncurrent portion | \$3,078,793 |

15. NOTE PAYABLE

Loan Agreement with China Cinda and its Affiliate

On August 18, 2010, the “Company and its wholly-owned subsidiaries Sifang, Shanghai TCH and Xi’an TCH entered into a Notes Purchase Agreement (the “Note Agreement”) with China Cinda (HK) Asset Management Co., Ltd, a company organized under the laws of the Hong Kong Special Administrative Region of China (“Cinda”). Under the terms of the Note Agreement, the Company will issue Cinda two tranches of convertible notes (the “Notes”), each having a principal amount equal to the US Dollar equivalent of RMB 50 million.

Under the Note Agreement, the Notes shall be issued before August 18, 2011. The Notes have a three-year maturity date from the date of the issuance of the first tranche. The exchange rate between RMB and US Dollar for each issue of Notes is the middle rate published by the People’s Bank of China (the “PBOC”) for the second business day prior to each issuance. Each Note bears interest at a rate equal to that of PBOC base interest rate for the relevant interest period (the period commencing on and including January 1 of each year and ending on and including December 31 of such year) plus 2%. If Cinda does not convert or fully convert the Notes to shares prior to maturity, the Company will pay the difference between the interest rate described above and 18% on the outstanding amount. As collateral for the notes, Mr. Ku, CEO of the Company entered into a Share Pledge Agreement with Cinda on August 18, 2010, to pledge each 4,500,000 shares of the Company’s common stock held by him to secure the first Note and the second note before its issuance, respectively.

Each Note had a conversion price at the lower of (i) \$2.46 per share or (ii) an amount equal to the Company’s EPS based upon the consolidated earnings of the Company for 2010 on a weighted average fully diluted basis, multiplied by seven. The Notes had a contingent BCF which will be recorded when the contingency is resolved.

Also on August 18, 2010, Xi'an TCH and China Jingu International Trust Co. Ltd. ("Jingu"), an affiliate of Cinda entered into a Capital Trust Loan Agreement ("Trust Loan Agreement"), in which Jingu would raise 100 million RMB (\$16 million) under a Jingu CREG Recycling Economy No. 1 Collective Fund Trust Plan ("Trust Plan") and lend such amount under the Trust Plan to Xi'an TCH (the "Loans"). If the Loans under the Trust Loan Agreement did not occur, then under the Note Agreement the principal amount of the Notes to be issued in each tranche would be the US dollar equivalent of RMB 100 million. In connection with the Trust Loan Agreement, the Company also entered into an Exchange Rights Agreement pursuant to which the Loans could be exchanged (on the same terms as the Notes can be converted) for shares of the Company's common stock which can in turn be registered under the Registration Rights Agreement. All proceeds from the Notes and the Loans were to be used to complete the Phases IV and V of the Erdos TCH Energy Saving Development Co., Ltd. ("Erdos TCH") project.

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The term of the Loans was for three years from the date of the first draw. The interest rate for the Loans is the PBOC three year loan base interest rate plus two percent (2%). If the Loans were not exchanged for shares of the Common Stock of the Company as described below prior to maturity, Xi'an TCH will pay the difference between the interest rate described above and 18% on the outstanding amount. Under the Trust Loan Agreement and separate agreements entered by Jingu, Erdos TCH, Shanghai TCH, Xi'an TCH and Mr. Guohua Ku on August 18, 2010, Erdos TCH was to pledge the accounts receivable, equipment and assets of its Phases IV and V projects to Jingu as a guarantee to the Loans, Xi'an TCH pledged its 80% equity in Erdos TCH to Jingu as a guarantee to the Loans, Shanghai TCH provided a joint liability guarantee to Jingu for the Loans, and Mr. Guohua Ku was to provide his personal joint liability to Jingu for the Loans.

On December 30, 2010, the Company received \$7,533,391 (RMB 50,000,000) from the first tranche of the Loans. On January 30, 2011, the Company received another \$7,533,391 (RMB 50,000,000) from the first tranche convertible Note. Under ASC 815 – Derivatives and Hedging, the FV of the conversion option was a derivative that was bifurcated and treated as liability at the date of inception. The conversion feature was accounted for at December 31, 2011 and 2010 using the conversion price of \$2.46. The conversion feature was akin to a call option, therefore, the Black-Scholes option pricing model was used by using the maximum conversion price of \$2.46 as the strike price. Since the conversion option was an embedded derivative and was bifurcated from the host contract, BCF analysis was not required. The FV of the conversion feature was recorded as a liability and was marked to market until the conversion rate was set. As the loan had a reset clause in the event the Company issued shares below the conversion price, it was to be treated as a liability as long as the loan was outstanding. The unamortized discount due to conversion feature continued to be amortized over the term of the loan; during the year ended December 31, 2011, the Company amortized \$10,747,493 due to BCF including the remaining unamortized portion as a result of repayment of the loans as described below.

On December 9, 2011, the Company, Cinda and Mr. Guohua Ku, the Chairman, CEO and a major shareholder of the Company entered into a Supplemental Agreement (the "Supplemental Agreement") to the Notes Purchase Agreement which was dated August 18, 2010. Pursuant to the terms of the Supplemental Agreement, the Company and Cinda terminated the transaction of the second tranche of RMB 50 million of the convertible note under the Note Agreement. The Company and Cinda also agreed that the Company would redeem the outstanding convertible note at the U.S. Dollar amount equivalent to RMB 25 million each on December 30, 2011 and November 30, 2012, respectively, plus accrued interest at 18% (the "*Redemption Interest Rate*") up to the applicable Redemption Date, minus any interest already accrued and paid (together with the Redemption Principal Amount, the "*Redemption Price*"). There was an additional 5% interest rate on any default in payment of the Redemption Price and due on demand. The interest on the Redemption Principal Amount due on November 30, 2012 (the "*Second Redemption Principal Amount*") accrued at 18%. Half of the amount owed was paid by the Company on June 20, 2012 and the remaining half was due on November 30, 2012; however, upon request from Cinda, the November 30, 2012 date was extended to a future date.

Xi'an TCH redeemed \$3.97 million (RMB 25 million) and interest of \$1.13 million (RMB 7.14 million) on December 30, 2011 per the Supplemental Agreement described above. During the year ended December 31, 2012, the Company amortized \$2,140,050 from the unamortized discount due to the conversion feature of the remaining RMB 25 million. As of December 31, 2012, there was no derivative liability as the Company redeemed half of the outstanding

convertible notes at December 30, 2011 and will redeem the remaining half at a future date, plus accrued interest at 18%. During the six and three months ended June 30, 2013, the Company recorded interest expense of \$360,137 and \$180,954 on the \$3.76 million (the remaining RMB 25 million) of Cinda note at 18%. The repayment of the Cinda note for the remaining \$3.76 million was, upon request from Cinda and per an oral agreement, extended from November 30, 2012 to a future date.

On December 9, 2011, Mr. Ku executed a Certificate for additional collateral to pledge an additional 1.5 million shares of common stock of the Company that he owns as collateral to Cinda to secure the unpaid note. In addition, on December 9, 2011, Xi'an TCH and Jingu, an affiliate of Cinda also entered into a Supplemental Agreement (the "Jingu Agreement") to the Capital Trust Loan Agreement. Pursuant to the terms of the Jingu Agreement, Xi'an TCH repaid \$7.94 million (RMB 50 million) and interest of \$1.00 million (RMB 6.45 million) to Jingu on December 16, 2011.

As of June 30, 2013 and December 31, 2012, the outstanding principal under China Cinda Note was \$3.77 million with accrued interest of \$0.18 million and \$0.38 million, respectively.

16. STOCK-BASED COMPENSATION PLAN

Options to Employees

On August 4, 2008, the Company granted certain employees stock options under the Company's 2007 Non-Statutory Stock Option Plan, which was later amended and restated in 2010, to acquire 3,000,000 shares of the Company's common stock, par value \$0.001, at \$0.80 per share. The options vest over three years and have a life of five years.

Based on the FV method under SFAS No. 123 (Revised) "Share Based Payment" ("SFAS 123(R)"), codified in FASB ASC Topic 718, the FV of each 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 each option granted to employees is recognized as compensation expense over the vesting period of each stock option award. The FV of the options was calculated using the following assumptions, estimated life of five years, volatility of 100%, risk free interest rate of 2.76%, and dividend yield of 0%. No estimate of forfeitures was made as the Company has a short history of granting options. The options were accounted for as a modification of the options cancelled on June 25, 2008. The grant date FV of options was \$5.04 million.

On November 9 and 11, 2009, the Company and three option holders agreed to cancel vested but unexercised options for 87,000 vested but unexercised shares and forfeit unvested options for 203,000 unvested shares. On November 11, 2009, the Company granted options to two other employees for 290,000 shares of the Company's common stock at \$2.35 per share. The options vested over three years and have a life of 5 years. The FV of the options was calculated using the following assumptions, estimated life of five years, volatility of 100%, risk free interest rate of 3.84%, and dividend yield of 0%. The grant date FV of options was \$518,513.

On August 13, 2010, the Company granted 2,200,000 options to acquire the Company's common stock at \$3.05 per share to 36 managerial and non-managerial employees as new equity awards pursuant to the Corporation's Amended and Restated 2007 plan. According to the vesting terms, the options granted were divided into three tranches, (i) 1/3 (one third) of the total number of shares subject to the options shall vest and become exercisable if the Company meets its minimum revenue and earnings goals in the Company's guidance for 2010 as delivered in its earnings releases and/or conference calls in the first quarter of 2010, such vesting to occur immediately upon completion of the annual audit confirming the financial results for 2010; and (ii) an additional 1/3 (one third) of the total number of shares subject to the options shall vest and become exercisable if the Company meets certain financial goals of 2011 which will be set out and decided by the Compensation Committee, such vesting to occur immediately upon Compensation Committee's determination that the Company has met such goals for 2011; and (iii) the remaining 1/3

(one third) of the total number of shares subject to the options shall vest and become exercisable if the Company meets certain financial goals of 2012 which is set out and decided by the Compensation Committee, such vesting is to occur immediately upon Compensation Committee's determination that the Company has met such goals for 2012. The Option may only be exercised to the extent that the Option has become vested and exercisable.

As of December 31, 2012 and 2011, the Company did not meet the financial goals of 2012 and 2011; accordingly, the second and third tranche (two thirds of the total number of 2,200,000 options) was forfeited.

The options have a life of five years. The FV of the options was calculated using the following assumptions; estimated life of five years, volatility of 92%, risk free interest rate of 3.54%, and dividend yield of 0%. Each tranche of the options is deemed to be independent of the others. Therefore, the fair value of the first tranche of options was fully expensed during fiscal year 2011; the second and third tranche of options were forfeited due to the non-achievement of established financial benchmarks.

The following table summarizes activity for employees in the Company's Plan:

| | Number of Shares | Average Exercise Price per Share | Weighted Average Remaining Contractual Term in Years |
|--------------------------------|---------------------|--|--|
| Outstanding at January 1, 2013 | 3,733,333 | \$ 1.36 | 1.09 |
| Exercisable at January 1, 2013 | 3,733,333 | \$ 1.36 | 1.09 |
| Granted | - | - | - |
| Exercised | - | - | - |
| Forfeited | - | - | - |
| Outstanding at June 30, 2013 | 3,733,333 | \$ 1.36 | 0.59 |
| Exercisable at June 30, 2013 | 3,733,333 | \$ 1.36 | 0.59 |

In July 2011, the Compensation Committee approved and provided the employees cashless exercise elections to the stock Options granted by the Board of Directors of the Company (the "Board") on August 4, 2008.

The Company recorded \$0 and \$112,814 compensation expense for stock options to employees during the six months ended June 30, 2013 and 2012, respectively. For the three months ended June 30, 2013 and 2012, the Company recorded \$0 and \$87,030, respectively. There were no options exercised during the six and three months ended June 30, 2013 and 2012, respectively.

Options to Independent Directors

On October 30, 2009, the Company granted stock options for 130,000 shares of the Company's common stock, at \$1.85 per share to three independent directors. The options vested and became exercisable on the six-month anniversary of the grant date with a life of five years. The FV of the options was calculated using the following assumptions: estimated life of five years, volatility of 100%, risk free interest rate of 3.54%, and dividend yield of 0%. The grant date FV of options was \$183,000.

On January 20, 2010, the Company granted stock options for 40,000 shares of the Company's common stock, at \$4.68 per share to another independent director. The options vested and became exercisable on the six-month anniversary of the grant date with a life of five years. The FV of the options was calculated using the following assumptions: estimated life of five years, volatility of 100%, risk free interest rate of 3.54%, and dividend yield of 0%. The grant date FV of options was \$142,000.

On October 7, 2010, our Board approved the increase in its size from seven to nine members as a result of entering the Loan and Note agreements with China Cinda and its affiliate on August 18, 2010. At the same time, our Board appointed Mr. Yilin Ma and Mr. Chungui Shi as new members of the Board to fill the director vacancies until their successors have been duly elected and qualified. In connection with their appointment, the Board authorized the Company to provide Mr. Shi 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, at an exercise price equal to the closing price per share of the Company's Common Stock on October 7, 2010. The options vested and became exercisable on the six-month anniversary of the grant date with a life of 5 years. The FV of the options was calculated using the following assumptions: estimated life of five years, volatility of 87%, risk free interest rate of 3.54%, and dividend yield of 0%. The grant date FV of options was \$83,000.

The following table summarizes option activity with respect to the independent directors:

| | Number of Shares | Average Exercise Price per Share | Weighted Average Remaining Contractual Term in Years |
|--------------------------------|---------------------|--|--|
| Outstanding at January 1, 2013 | 210,000 | \$ 2.60 | 2.05 |
| Exercisable at January 1, 2013 | 210,000 | \$ 2.60 | 2.05 |
| Granted | - | - | - |
| Exercised | - | - | - |
| Forfeited | - | - | - |
| Outstanding at June 30, 2013 | 210,000 | \$ 2.60 | 1.55 |
| Exercisable at June 30, 2013 | 210,000 | \$ 2.60 | 1.55 |

No options were exercised during the six and three months ended June 30, 2013 or 2012.

Warrants to Investor Relation Firms

On October 1, 2009, the Company granted warrants to acquire 200,000 shares of the Company's common stock, at \$1.50 per share to certain investor relations firms. The warrants are exercisable, in whole or in part, at any time from July 1, 2010 (the "Vesting Date") to October 1, 2014 (the "Expiration Date"). The Company accounted for warrants issued to investor relations firms based on ASC 505-50 at each balance sheet and expense recorded based on the period elapsed at each balance sheet date, which is the date at which the counterparty's performance is deemed to be completed for the period. The FV of each warrant granted is estimated on the date of the grant using the BSOPM under ASC 505-30-11 and is recognized as compensation expense over the service term of the investor relations agreement as it is a better matching of cost with services received. Under that Agreement, the issuance of the warrants was irrevocable and the Company agreed to take no action to cause the warrants to be void or revoked or their issuance to be otherwise terminated. The warrants are classified as equity instruments and are exercisable into a fixed number of common shares. There is no commitment or requirement to change the quantity or terms based on conditions to the counterparty's performance or market conditions. The FV of the warrants was calculated using the following assumptions: estimated life of five years, volatility of 100%, risk free interest rate of 3.54%, and dividend yield of 0%.

The following table summarizes activity for the warrants to certain investor relations IR firms:

| | Number of Shares | Average Exercise Price per Share | Weighted Average Remaining Contractual Term in Years |
|--------------------------------|---------------------|--|--|
| Outstanding at January 1, 2013 | 50,000 | \$ 1.50 | 1.75 |
| Exercisable at January 1, 2013 | 50,000 | \$ 1.50 | 1.75 |
| Granted | - | - | - |
| Exercised | - | - | - |
| Forfeited | - | - | - |
| Outstanding at June 30, 2013 | 50,000 | \$ 1.50 | 1.25 |
| Exercisable at June 30, 2013 | 50,000 | \$ 1.50 | 1.25 |

There were no warrants exercised during the six and three months ended June 30, 2013 or 2012.

17. STATUTORY RESERVES

Pursuant to the corporate law of the PRC effective January 1, 2006, the Company is only required to maintain one statutory reserve by appropriating from its after-tax profit before declaration or payment of dividends. The statutory reserve represents restricted retained earnings.

Surplus Reserve Fund

The Company's Chinese subsidiaries are required to transfer 10% of their net income, as determined under PRC accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the Company's registered capital.

The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

18. CONTINGENCIES

Xi'an TCH was granted a subsidy by Xi'an City Science and Technology Bureau and Xi'an City Finance Bureau under Xi'an Hi-Tech Industry Development Special Project Fund. The special project fund for Xi'an TCH is for a three years period, from January 1, 2012 to December 31, 2014, with two criteria established to measure the performance of Xi'an TCH: (i) total accumulated sales in three years should be RMB 320 million (\$50.8 million), and (ii) total accumulated taxable income should be RMB 56.9 million (\$ 9.0 million). In 2012, Xi'an TCH's total sales were RMB 129 million (\$20.5 million) and total taxable income was RMB 59.8 million (\$9.5 million) under PRC GAAP. Xi'an TCH achieved total accumulated taxable income target of RMB 56.9 million (\$9.0 million) in 2012 under PRC GAAP. For the six months ended June 30, 2013, Xi'an TCH's total sales were RMB 64.85 million (\$10.39 million) under PRC GAAP. The probability of achieving total accumulated sales of RMB 320 million (\$50.8 million) for the three years period was evaluated by the management. Based on management's evaluation, Xi'an TCH had seven projects in operation with minimum monthly lease payments of RMB 10.5 million (\$1.69 million) under PRC GAAP; as a result, management believes that achieving total accumulated sales target of RMB 320 million (\$50.8 million) over a period of three years is probable and therefore recognized the subsidy income in 2012. Total subsidy income for 3 years was \$499,000 (RMB 3,150,000) and Xi'an TCH paid third party consulting company fees of \$149,700 (RMB 945,000), for services relating to project evaluation and audit, application document preparation, assembling and compiling and net subsidy received was \$349,300 (RMB 2,205,000), which was recorded as part of other income. Xi'an TCH will return the funds to the authority if it does not meet the sales target.

19. COMMITMENTS

Lease Commitment

On March 5, 2010, Xi'an TCH leased its office under a two year operating lease that expired March 4, 2012. The Company renewed the lease for two years until March 4, 2014, and it can be renewed with the monthly payment increasing by 8% after March 5, 2014. Currently, the monthly rental payment is \$18,000. In March 2013 Xi'an TCH leased an office in Jinan for three years until March 22, 2016, with a monthly payment of \$3,800. The rents will be increased at 5% each year. For the six months ended June 30, 2013 and 2012, the rental expense of Xi'an TCH was \$148,100 and \$100,507, respectively; for the three months ended June 30, 2013 and 2012, the rental expense was \$93,566 and \$50,250, respectively.

In November 2012, Sifang Holding renewed its office in Beijing for monthly rent of \$1,900 expiring on December 18, 2013. Sifang was required to pay in advance for the first six months rent for \$11,450 at the beginning of the lease. The lease will be automatically renewed when it expires.

Future minimum annual rental payments required under operating leases as of June 30, 2013 were as below (by year):

| | |
|-------|-------------|
| 2014 | \$293,000 |
| 2015 | 311,000 |
| 2016 | 288,000 |
| 2017 | 305,000 |
| 2018 | 305,000 |
| Total | \$1,502,000 |

Shanxi Datong Coal Group Power Generation Projects

In February 2011, Xi'an TCH signed a contract with Shanxi Datong Coal Group Steel Co., Ltd (the "Shanxi Datong") to recycle gas and steam from groups of blast-furnaces and converter of Shanxi Datong's metal refining plants to generate power. According to the contract, Xi'an TCH will install two 3MW BPRT, one 15MW WGPG and two 1MW steam power generation systems, with a total of 23MW power capacity for an estimated total investment of \$27.45 million (RMB 180 million). The lease term is 30 years. During the term of the lease, Shanxi Datong will pay service fee to Xi'an TCH. The service fee is based on an average of 8,000 electricity-generating hours per year and \$0.05 (RMB 0.33) per kilowatt hour ("kWh") for the first 5 years from the completion of each power generation station. For each of the leases, at the 6th year, 11th year and 21st year thereafter, the rate will be RMB 0.3 kWh, 0.27 kWh and 0.25 kWh, respectively. After 30 years, the units will be transferred to Shanxi Datong without any charge.

As of June 30, 2013, the two 3 MW BPRT systems were completed, and the Company paid \$13.22 million for the remaining Shanxi Datong Coal Group Power Generation project. The Company is committed to pay an additional \$5.50 million for the Shanxi Datong Coal Group Power Generation project. The Company expects to complete the project by the end of 2013.

Jilin Ferroalloys Power Generation Projects

In May 2013, Xi'an TCH signed a contract with Sinosteel Jilin Ferroalloys Co., Ltd. ("Jitie") to build furnace gas waste heat power generation systems for electricity generation from recycled heat and steam from groups of ferroalloy furnaces and electric furnaces ("Jitie project"). According to the contract, Xi'an TCH will install a 7.5 MW and a 3 MW turbine power generation system, with a total of 10.5 MW power capacity for an estimated total investment of \$9.71 million (RMB 60 million). The lease term is 24 years. During the term of the lease, Jitie will pay a service fee to Xi'an TCH based on the actual generating capacity with the minimum service fee per month of \$0.3 million (RMB 1.8 million). The actual generating capacity is based on an average of 7,200 and 5,760 electricity-generating hours per year for 7.5 MW and 3 MW systems, respectively, and \$0.07 (RMB 0.42) per kilowatt hour ("kWh") as settlement price. Xi'an TCH will be responsible for the systems operation and have the ownership of power generation systems. On May 12, 2013, Xi'an TCH entered into an agreement with Xi'an Huaxin Energy Tech Co., Ltd (the contractor for construction) for constructing the Jitie project. The project was scheduled to be completed 12 months from construction commencement and will be done according to the model of Energy Management Contract" (EMC). Xi'an has paid \$4.86 million and is committed to pay additional \$4.86 million for the Jitie project, by the end of May 2014.

20. SUBSEQUENT EVENT

On July 19, 2013, Xi'an 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, Xi'an Zhonghong New Energy Technology Co., Ltd. ("Zhonghong"), a 90% owned subsidiary of the Company entered into a Cooperative Agreement of Coke Dry Quenching (CDQ) and CDQ Waste Heat Power Generation Project (the "Project") with Boxing County Chengli Gas Supply Co., Ltd. ("Chengli"), including a supplement agreement entered by the parties on July 26, 2013 (collectively, the "Agreements").

Pursuant to the Agreements, Zhonghong will design, build and maintain a 25 MW CDQ system and a CDQ waste heat power generation 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 system and CDQ waste heat power generation system at no cost to Zhonghong. The term of the Agreements is for 20 years. The first 800 million watt hours generated by the Project will be charged at RMB 0.42 per kilowatt hour (excluding tax) and after the initial 800 million watt hours, the energy saving fee will be RMB 0.20 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 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 is anticipated to be completed in 12 months from the date the parties enter into a Technical Agreement. 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 and the CDQ waste heat power generation system will be no less than 7,200 hours/year.

On July 19, 2013, Zhonghong entered into a Cooperative Agreement for Energy Management of Coke Dry Quenching (CDQ) and CDQ Waste Heat Power Generation Project (the "Tianyu Project") with Jiangsu Tianyu Energy and Chemical Group Co., Ltd. ("Tianyu") (the "Tianyu Agreement").

Pursuant to the Tianyu Agreement, Zhonghong will design, build, operate and maintain two sets of 25 MW CDQ systems and CDQ waste heat power generation 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 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 a year due to the reason attributable to Tianyu, then then time charged shall be 8,000 hours a year. The construction of the Tianyu Project is anticipated to be completed in 14 months from the date the parties enter into a Technical Agreement. Tianyu will provide the land for the CDQ systems and CDQ waste heat power generation systems for free. Tianyu also provided guarantee to purchase all the power generated by CDQ Waste Heat Power Generation system.

On August 3, 2013, 12 option holders sent exercise notices to the Company to cashless exercise their stock options granted on August 4, 2008 under the Company's 2007 Non-Statutory Stock Option Plan (see note 16). The exercised option shares are for 2,650,000 shares and the Company plans on issuing 1,885,834 common stock shares to the option holders pursuant to the cashless exercise formula approved by its Compensation Committee.

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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 “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.

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

The Company was incorporated on May 8, 1980 as “Boulder Brewing,” under the laws of the State of Colorado. On September 6, 2001, the Company re-domiciled its state of incorporation from Colorado to Nevada. On March 8, 2007, the Company changed its name to “China Recycling Energy Corporation.” The Company, through its subsidiaries Shanghai TCH Energy Technology Co., Ltd. (“Shanghai TCH”) and Huahong New Energy Technology Co, Ltd, sells

and leases energy saving systems and equipment to its customers.

Our business is primarily conducted through our wholly-owned subsidiary, Sifang Holdings, its wholly-owned subsidiaries, Huahong New Energy Technology Co., Ltd. (“Huahong”) and Shanghai TCH, Shanghai TCH’s wholly-owned subsidiaries, Xi’an TCH Energy Technology Company, Ltd (“Xi’an TCH”), and Xi’an TCH’s subsidiary Erdos TCH Energy Saving Development Co., Ltd (“Erdos TCH”), in which 93% of the initial investment came from from Xi’an TCH, pursuant to a joint venture between Xi’an TCH and Erdos Metallurgy Co., Ltd. Shanghai TCH was established as a foreign investment enterprise in Shanghai under the laws of the PRC on May 25, 2004, currently with registered capital of \$29.80 million. On June 15, 2013, Xi’an TCH and Erdos Metallurgy entered into a share transfer agreement; Erdos Metallurgy transferred its 7% share in Erdos TCH, to Xi’an TCH at cost, \$1.29 million (RMB 8 million). Xi’an TCH paid this in July 2013 and became the 100% shareholder of Erdos TCH. Xi’an TCH was incorporated in Xi’an, Shaanxi Province under the laws of the PRC on November 8, 2007. Erdos TCH was incorporated in April 2009. Huahong was incorporated in February 2009.

As of June 30, 2013, we have one TRT system, two CHPG systems, five recycling waste heat power generating systems from the Erdos projects, three BMPG systems, one WHPG system of Zhongbao, and two BPRT systems of Shanxi Datong under sales-type leases.

Erdos TCH – Joint Venture

On April 14, 2009, the Company incorporated a joint venture (“JV”) with Erdos Metallurgy Co., Ltd. (“Erdos”) to recycle waste heat from Erdos' metal refining plants to generate power and steam, which will then be sold back to Erdos. The name of the JV is Inner Mongolia Erdos TCH Energy Saving Development Co., Ltd (“Erdos TCH”) with a term of 20 years, and initial registered capital of \$2,635,000 (RMB 18,000,000). As of June 30, 2013, total registered capital was increased to \$17.55 million (RMB 120 million). Prior to June 15, 2013, Erdos contributed 7% of the total investment of the project, and Xi'an TCH contributed 93%. With respect to profit distribution, Xi'an TCH and Erdos were to receive 80% and 20% of the profit from the JV, respectively, until Xi'an TCH had received the complete return of its investment. Xi'an TCH and Erdos were to then receive 60% and 40% of the profit from the JV, respectively. The profits to be distributed were to be computed based on Chinese generally accepted accounting principles. The principal difference between US GAAP and Chinese GAAP, with regards to the Erdos TCH project, is that a sales-type lease under US GAAP is treated as an operating lease under Chinese GAAP. When the term of the JV expires, Xi'an TCH was to transfer its equity in the JV to Erdos at no cost. On June 15, 2013, Xi'an TCH and Erdos Metallurgy entered into a share transfer agreement; Erdos Metallurgy transferred its 7% share in Erdos TCH, to Xi'an TCH at cost, \$1.29 million (RMB 8 million). Xi'an TCH paid this in July 2013 and became the 100% shareholder of Erdos TCH. In addition, Xi'an TCH is required to pay Erdos Metallurgy, accumulated profits from inception up to the transfer date in the amount of \$227,901. Since there were no material transactions from June 15, 2013 to June 30, 2013, Xi'an TCH and Erdos Metallurgy entered into profit allocation supplementary agreement to allocate profits to Erdos Metallurgy up to and for the period ended June 30, 2013.

Shanxi Datong Coal Group Power Generation Projects

In February 2011, Xi'an TCH signed a contract with Shanxi Datong Coal Group Steel Co., Ltd (the “Shanxi Datong”) to recycle gas and steam from groups of blast-furnaces and converter of Shanxi Datong's metal refining plants to generate power. According to the contract, Xi'an TCH will install two 3MW TRT, one 15MW WGPG and two 1MW steam power generation systems, with a total of 23MW power capacity for an estimated total investment of \$28.6 million (RMB 180 million). In June 2013, the two 3MW BPRT power generation systems were completed. The lease term is 30 years. During the lease term, Shanxi Datong will pay a service fee to Xi'an TCH. The service fee is based on an average of 8,000 electricity-generating hours per year and \$0.05 (RMB 0.33) per kilowatt hour (“kWh”) for the first five years from the completion of each power generation station. For each of the leases, at the 6th year, 11th year and 21st year thereafter, the rate will be RMB 0.3 kWh, 0.27 kWh and 0.25 kWh, respectively. On June 10, 2013, Xi'an TCH and Shanxi Datong entered into a supplemental agreement for the minimum service fee. The minimum service fee per month for the first five years is \$0.19 million (RMB 1.2 million), \$0.18 million (\$1.1 million) for the second five years, \$0.16 (RMB 1.0 million) for the following ten years and \$0.15 million (RMB 0.9 million) for the last ten years. After 30 years, the units will be transferred to Shanxi Datong without charge.

As of June 30, 2013, the Company paid \$13.22 million for the remaining Shanxi Datong Coal Group Power Generation project and is committed to paying an additional \$5.50 million. The Company expects to complete the Datong project by the end of 2013.

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. (the "Shenqiu") for Xi'an TCH to reconstruct and transform a Thermal Power Generation System owned by Shenqiu into a 75T/H Biomass Power Generation 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. Per the Transfer Agreement, Shenqiu sold to Xi'an TCH a set of 12 MW biomass power generation systems, effectuation of such sale occurring after Xi'an TCH converted the system for biomass power generation purposes. As consideration for the biomass power generation system, 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 system. 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 "Lease Agreement"). Under the Lease Agreement, Xi'an TCH agreed to lease a set of 12MW biomass power generation systems to Shenqiu for \$286,000 (RMB 1,800,000) per month for 11 years. Upon completion of the Lease Agreement, ownership of this system will be transferred from Xi'an TCH to Shenqiu at no cost. Shenqiu provided one month leasing fee as security deposit to Xi'an TCH as well as personal guarantees from its legal representative.

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 technical reformation involved the construction of another 12MW biomass power generation system. After the reformation, the generation capacity of the power plant increased to 24MW. The project commenced on October 25, 2012 and was completed during the first quarter of 2013. During the construction period, from November 2012 to March 2013, Xi'an TCH agreed to stop charging Shenqiu Phase I rental fees. On March 30, 2013, Xi'an TCH and Shenqiu entered into a Biomass Power Generation Project Lease Agreement (the "Lease Agreement"). Under the Lease Agreement, Xi'an TCH agreed to lease the second set of 12MW biomass power generation systems to Shenqiu for \$239,000 (RMB 1,500,000) per month for 9.5 years. Upon completion of the Lease Agreement, ownership of this system will be transferred from Xi'an TCH to Shenqiu at no cost.

Jilin Ferroalloys Power Generation Projects

In May 2013, Xi'an TCH signed a contract with Sinosteel Jilin Ferroalloys Co., Ltd. ("Jitie") to build furnace gas waste heat power generation systems for electricity generation from recycled heat and steam from groups of ferroalloy furnaces and electric furnaces ("Jitie project"). According to the contract, Xi'an TCH will install a 7.5 MW and a 3 MW turbine power generation system with a total of 10.5 MW power capacity for an estimated total investment of \$9.71 million (RMB 60 million). The lease term is 24 years. During the term of the lease, Jitie will pay a service fee to Xi'an TCH based on the actual generating capacity with a minimum service fee per month of \$0.3 million (RMB 1.8 million). Xi'an TCH will be responsible for the systems operation and will own the power generation systems. On May 12, 2013, Xi'an TCH entered into an agreement with Xi'an Huaxin Energy Tech Co., Ltd (the contractor for construction) for the construction of the Jitie project. The project is scheduled to be completed 12 months from construction commencement.

Waste Heat Power Generation Project

On June 25, 2013, the Company's subsidiary, Xi'an TCH, with Hongyuan Huifu Venture Capital Co. Ltd ("Hongyuan Huifu") jointly established Hongyuan Recycling Energy Investment Management Co., Ltd ("Hongyuan Management"), with registered capital of RMB 10 million, to manage a fund that will be used for financing a coke dry quenching ("CDQ") waste heat power generation project (See note 10). Xi'an TCH paid RMB 4 million (\$0.65 million) and owns 40% of Hongyuan Management.

Zhonghong New Energy Technology Co., Ltd

On July 19, 2013, the Company 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 the Company. Zhonghong is engaged to provide energy saving solutions and services, including constructing, selling and leasing energy saving systems and equipment to customers.

Related Party Transactions

Erdos TCH sold all power generation stations through sales type leases to Erdos Metallurgy Co., Ltd., the non-controlling interest holder (Erdos Metallurgy sold all its ownership shares in Erdos TCH to Xi'an TCH on June 15, 2013). Total sales and interest income for this non-controlling interest was \$0.30 million and \$3.68 million for the six months ended June 30, 2013, and \$0.38 million and \$3.70 million for the six months ended June 30, 2012; \$0.1

million and \$1.85 million for the three months ended June 30, 2013, and \$0.28 million and \$1.84 million for the corresponding 2012 period, respectively.

As of June 30, 2013, Xi'an TCH purchased Erdos Metallurgy's interest in Erdos TCH, as a result Erdos Metallurgy is no longer a related party.

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, which were prepared in accordance with 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 on 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 consolidated financial statements, we believe the following accounting policies are the most critical to aid you in fully understanding and evaluating this management discussion and analysis.

Basis of Presentation

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

Basis of Consolidation

The consolidated financial statements include the accounts of CREG and, its subsidiary, Sifang Holdings; Sifang Holdings' wholly owned subsidiaries, Huahong and Shanghai TCH; Shanghai TCH's subsidiary Xi'an TCH; and Erdos TCH, in which 93% of Erdos TCH's investment was from Xi'an TCH (Erdos Metallurgy sold all its ownership shares in Erdos TCH to Xi'an TCH on June 15, 2013). 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, 2013 and December 31, 2012, respectively. All significant inter-company accounts

and transactions were eliminated in consolidation.

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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.

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 usually 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 Statement of Financial Accounting Standards ("SFAS") No. 13, "Accounting for Leases" (codified in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 840) and its various amendments and interpretations. The Company manufactures and constructs the waste energy recycling power generating projects and finances its customers for the price of the projects. The sales and cost of sales are recognized at the time of sale or inception of the lease. The investment in sales-type leases consists of the sum of the total minimum lease payments receivable less unearned interest income and estimated executory cost. Unearned interest income is amortized to income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease. While a portion of revenue is recognized at the inception of the lease, the cash flow from the sales-type lease occurs over the course of the lease. Revenue is net of 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 the Renminbi ("RMB"). For financial reporting purposes, RMB were translated into United States dollars ("USD") 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 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 SFAS 130 "Reporting 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.

RESULTS OF OPERATIONS**Comparison of Three Months Ended June 30, 2013 and 2012**

The following table sets forth the results of our operations for the periods indicated as a percentage of net sales:

| | 2013 | | 2012 | |
|--|--------------|------------|--------------|------------|
| | | % of Sales | | % of Sales |
| Sales | \$13,912,563 | 100 % | \$403,420 | 100 % |
| Sales of systems | 13,623,004 | 98 % | - | - % |
| Contingent rental income | 289,559 | 2 % | 403,420 | 100 % |
| Cost of sales ("COS") | 10,501,936 | 75 % | 28,568 | 7 % |
| Cost of systems | 10,501,936 | 75 % | 28,568 | 7 % |
| Gross profit | 3,410,627 | 25 % | 374,852 | 93 % |
| Interest income on sales-type lease | 4,728,706 | 34 % | 4,713,727 | 1168 % |
| Total operating income | 8,139,333 | 59 % | 5,088,579 | 1261 % |
| Total operating expenses | (684,114) | (5)% | (809,140) | (201)% |
| Income from operations | 7,455,219 | 54 % | 4,279,439 | 1060 % |
| Total non-operating expenses, net | (1,228,696) | (9)% | (2,470,624) | (612)% |
| Income before income tax | 6,226,523 | 45 % | 1,808,815 | 448 % |
| Income tax expense | 2,366,816 | 17 % | 454,689 | 113 % |
| Less: net income attributable to noncontrolling-interest | 126,363 | 1 % | 130,004 | 32 % |
| Net income attributable to China Recycling Energy Corp | \$3,733,344 | 27 % | \$1,224,122 | 303 % |

SALES. Total sales, including system sales and contingent rental income, for the three months ended June 30, 2013 was \$13.91 million while total sales for the comparable period of 2012 was \$0.40 million, an increase of \$13.51 million as a result of increases in the sales of systems. Of the total sales, sales of systems for the three months ended June 30, 2013 was \$13.62 million, as compared to \$0 million for the comparable period of 2012, an increase of \$13.62 million. For the three months ended June 30, 2013, Shanxi Datong Phase I project - two 3MW BPRT power generation systems were completed and sold. In comparison, in the same period of 2012, none of the Company's power generation system were completed and sold. For the three months ended June 30, 2013, the Company received contingent rental income of \$0.29 million from the usage of electricity in addition to the minimum lease payments, compared to \$0.40 million for the comparable period in 2012. For the sales-type lease, sales and cost of sales ("COS") are recorded at the time of leases; interest income from the sales-type leases is our other major revenue source in addition to sales revenue.

COST OF SALES. COS for the three months ended June 30, 2013 was \$10.50 million while our COS for the comparable period of 2012 was \$28,568, an increase of \$10.48 million. This increase was mainly due to the completion and sale of the Shanxi Datong Phase I project.

GROSS PROFIT. Gross profit was \$3.41 million for the three months ended June 30, 2013 compared to \$0.37 million for the comparable period of 2012, a blended gross margin of 25% and 93% for the comparable periods of 2013 and 2012, respectively, the decreased profit margin in the three months ended June 30, 2013 was mainly due to the low profit margin realized from the sale of Shangxi Datong Phase I project.

INTEREST INCOME ON SALES TYPE LEASES. Interest income on sales-type leases for the three months ended June 30, 2013 was \$4.73 million, a \$0.02 million increase from \$4.71 million for the comparable period of 2012. During the second quarter of 2013, interest income was derived from 12 systems: one TRT system, two CHPG systems, two systems with Erdos Phase I project and three systems of Erdos Phase II project, the Pucheng biomass power generation system, two Shenqiu biomass power generation systems and Zhongbao WHPG system. The Company sold Shanxi Datong Phase I project - two 3MW BPRT power generation systems in June 2013 and started collecting payments in July. In comparison, during the second quarter of 2012, interest income was derived from 11 systems: one TRT systems, two CHPG systems, two systems with Erdos Phase I project and three systems of Erdos Phase II project, the Pucheng biomass power generation system, Shenqiu biomass power generation system and Zhongbao WHPG system.

OPERATING EXPENSES. Operating expenses consisted of selling, general and administrative expenses totaling \$0.68 million for the three months ended June 30, 2013 as compared to \$0.81 million for the comparable period of 2012, a decrease of \$0.13 million or 16%. This was mainly due to a decrease of \$0.09 million expense for stock option compensation and \$0.04 million for consulting and IR service.

NON-OPERATING INCOME (EXPENSES). Non-operating expenses consisted of non sales-type lease interest income, interest expense, bank charges and miscellaneous expenses. For the three months ended June 30, 2013, net non-operating expense was \$1.23 million compared to \$2.47 million for the comparable period of 2012. For the three months ended June 30, 2013, we had \$1.29 million interest expense on loans For the comparable period of 2012, we had \$1.67 million interest expense on loans, \$0.85 million interest expense arising from the conversion feature of the convertible note.

INCOME TAX EXPENSE. Income tax expense was \$2.37 million for the three months ended June 30, 2013, an increase of \$1.92 million from \$0.45 million for the comparable period of 2012. The increase was mainly due to significantly increased taxable income, and the expiration of 15% preferential income tax rate of Xi'an TCH in August 2012, and subject to regular 25% income tax rate since then. The consolidated effective income tax rate for the three months ended June 30, 2013 and 2012 was 38.0% and 25.1%, respectively.

NET INCOME. Net income for the three months ended June 30, 2013 was \$3.73 million compared to \$1.22 million for the comparable period of 2012, an increase of \$2.51 million. This increase in net income was mainly due to the increased sales, interest income on sales-type leases, and decreased non-operating expenses compared with the same period of 2012.

Comparison of Six Months Ended June 30, 2013 and 2012

The following table sets forth the results of our operations for the periods indicated as a percentage of net sales:

| | 2013 | | | 2012 | | |
|--|--------------|------------|----|--------------|------------|----|
| | | % of Sales | | | % of Sales | |
| Sales | \$28,253,134 | 100 | % | \$550,973 | 100 | % |
| Sales of systems | 27,702,800 | 98 | % | - | - | % |
| Contingent rental income | 550,334 | 2 | % | 550,973 | 100 | % |
| Cost of sales ("COS") | 21,402,848 | 76 | % | (42,951) | 8 | % |
| Cost of systems | 21,402,848 | 76 | % | (42,951) | 8 | % |
| Gross profit | 6,850,286 | 24 | % | 508,022 | 93 | % |
| Interest income on sales-type lease | 8,553,546 | 30 | % | 9,527,977 | 1729 | % |
| Total operating income | 15,403,832 | 54 | % | 10,035,999 | 1822 | % |
| Total operating expenses | (1,766,560) | 6 | % | (1,588,695) | 289 | % |
| Income from operations | 13,637,272 | 48 | % | 8,447,304 | 1533 | % |
| Total non-operating expenses, net | (2,631,584) | (9 |)% | (4,009,598) | (728 |)% |
| Income before income tax | 11,005,688 | 39 | % | 4,437,706 | 805 | % |
| Income tax expense | 3,726,870 | 13 | % | 942,081 | 171 | % |
| Less: net income attributable to noncontrolling interest | 247,284 | 1 | % | 248,938 | 45 | % |
| Net income attributable to China Recycling Energy Corp | \$7,031,534 | 25 | % | \$3,246,687 | 589 | % |

SALES. Net sales of systems for the six months ended June 30, 2013 were \$28.25 million while our net sales for the same period of 2012 were \$0.55 million, an increase of \$27.70 million. The increase was primarily due to Shenqiu Phase II project and Shanxi Datong Phase I project being completed and sold in 2013. No power generation system being completed and sold in 2012, and only \$0.55 million from contingent rental income during six months ended June 30, 2012. For the six months ended June 30, 2013, the Company received contingent rental income of \$0.55 million from actual usage of the electricity in addition to the minimum lease payments, which is the same for the comparable period in 2012. For the sales-type lease, sales and COS are recorded at the time of leases; the interest income from the sales-type leases is our other major revenue source in addition to sales revenue.

COST OF SALES. COS for the six months ended June 30, 2013 was \$21.40 million while our COS for the comparable period of 2012 was \$0.04 million, an increase of \$21.36 million. This increase was mainly due to the completion and sales of Shenqiu Phase II project and Shanxi Datong Phase I project (two 3MW BPRT power generation systems).

GROSS PROFIT. Gross profit was \$6.85 million for the six months ended June 30, 2013 compared to \$0.51 million for the comparable period of 2012, a gross margin of 24% and 92% for the comparable period of 2013 and 2012, respectively. The decrease in gross profit was primarily due to the low profit margin realized from the sale of Shangxi Datong Phase I project.

INTEREST INCOME ON SALES TYPE LEASES. Interest income on sales-type leases for the six months ended June 30, 2013 was \$8.55 million, a \$0.97 million decrease from \$9.53 million for the comparable period of 2012. During the six months ended June 30, 2013, interest income was derived from 12 systems: one TRT system, two CHPG systems, two systems with Erdos Phase I project and three systems of Erdos Phase II project, the Pucheng biomass power generation system, two Shenqiu biomass power generation systems and Zhongbao WHPG system. The Company sold Shanxi Datong Phase I project in June 2013 and started collecting payments in July. In comparison, during the six months ended June 30, 2012, interest income was derived from 11 systems: one TRT systems, two CHPG systems, two systems with Erdos Phase I project and three systems of Erdos Phase II project, the Pucheng biomass power generation system, Shenqiu biomass power generation system and Zhongbao WHPG system.

OPERATING EXPENSES. Operating expenses consisted of selling, general and administrative expenses totaling \$1.77 million for the six months ended June 30, 2013 compared to \$1.59 million for the comparable period of 2012, an increase of \$0.18 million or 11%. This was mainly due to an increase of \$0.12 million salary expense, and an increase of \$0.08 million rental and office expenses, but partially offset by decreased stock option expense, and consulting and IR service.

NON-OPERATING INCOME (EXPENSES). Non-operating expenses consisted of non-sales-type lease interest income, interest expense, bank charges and some miscellaneous expenses. For the six months ended June 30, 2013, net non-operating expense was \$2.63 million compared to \$4.01 million for the comparable period of 2012. In the six months ended June 30, 2013 we had \$2.79 million interest expense on loans. In the six months ended June 30, 2012,

we had \$3.45 million interest expense on loans and \$1.67 million interest expense arising from the BCF of the convertible note, but offset by \$1.13 million from changes in fair value of BCF of the convertible note.

INCOME TAX EXPENSE. Income tax expense was \$3.73 million for the six months ended June 30, 2013, an increase of \$2.79 million from \$0.94 million for the comparable period of 2012. The increase was mainly due to significantly increased taxable income, and the expiration of 15% preferential income tax rate of Xi'an TCH in August 2012, and subject to regular 25% income tax rate since then. The consolidated effective income tax rate for the six months ended June 30, 2013 and 2012 was 33.9% and 21.2%, respectively.

NET INCOME. Our net income for the six months ended June 30, 2013 was \$7.03 million compared to \$3.25 million for the comparable period of 2012, an increase of \$3.78 million. This increase in net income was mainly due to two projects being completed and sold in 2013 compared with no systems sold in the comparable period of 2012.

Liquidity and Capital Resources

Comparison of the six months ended June 30, 2013 and 2012

As of June 30, 2013, the Company had cash and equivalents of \$32.63 million, other current assets of \$14.80 million, current liabilities of \$62.53 million, a working capital deficit of \$(15.10) million, and a debt-to-equity ratio of 0.50:1.

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, 2013 and 2012:

| | 2013 | 2012 |
|-----------------------------|---------------|--------------|
| Cash provided by (used in): | | |
| Operating Activities | \$(8,130,208) | \$28,752,483 |
| Investing Activities | 1,201,440 | (680,019) |
| Financing Activities | (6,085,472) | (1,224,184) |

Net cash used in operating activities was \$8.13 million during the six months ended June 30, 2013, compared to \$28.75 million provided by operating activities in the comparable period of 2012. The decrease in net cash inflow was mainly from increases in sales type lease receivables from the sale of Shenqiu Phase II system and Shanxi Datong Phase I systems; however, this decrease was partially offset by the increased net income. The Shenqiu Phase II project commenced construction in October 2012 and was completed at the end of the first quarter of 2013; Shanxi Datong Phase I project (two 3MW BPRT power generation systems) commenced in February 2011 and was completed at June 2013, which resulted in cash inflow of \$10.0 million from construction in progress in 2013, but was partially offset by payments of \$4.81 million for construction related to the Shanxi Datong Coal Group Power Generation Phase II and Jitie Projects. The construction was considered an operating activity due to the similar nature of producing inventory for sale.

Net cash provided by investing activities was \$1.20 million for the six months ended June 30, 2013, compared to \$0.68 million outflow in the comparable period of 2012. The increase of net cash provided by investing activities was mainly due to, the release of \$1.86 million from restricted cash but partially offset with the new investment of \$0.64 million in forming a fund management company. In the comparable period of 2012, the cash outflow was due to the deposit of \$0.68 million into a bank as restricted cash.

On June 25, 2013, the Company's subsidiary, Xi'an TCH, with Hongyuan Huifu Venture Capital Co. Ltd ("Hongyuan Huifu") jointly established Hongyuan Recycling Energy Investment Management Co., Ltd ("Hongyuan Management"), with registered capital of RMB 10 million (\$1.6 million), to manage a fund that will be used for financing a coke dry quenching ("CDQ") waste heat power generation project (See note 10). Xi'an TCH paid RMB 4 million (\$0.65 million) and owns 40% of Hongyuan Huifu.

Net cash used in financing activities was \$6.09 million for the six months ended June 30, 2013 compared to net cash used in financing activities of \$1.22 million for the comparable period of 2012. The cash outflow in the six months ended June 30, 2013 included \$9.45 million repayment of bank loans and \$0.80 million increased notes receivable, which was partially offset by the \$4.80 million proceeds from bank loans. In comparison, for the comparable period of 2012, we had \$4.76 million proceeds from a bank loan, which was offset by the repayment of a bank loan of \$1.90 million and \$3.42 million repayment to related parties.

We believe we have sufficient cash to continue our current business through 2013 due to recurring receipts from sales-type leases in place. As of June 30, 2013, we have one TRT system, two CHPG systems, five recycling waste heat power generating systems from the Erdos projects, three BMPG systems, one WHPG system of Zhongbao, and two BPRT system of Shanxi Datong to generate net cash inflow. 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 2013.

We do not believe inflation has had a significant negative impact on our results of operations in 2013.

Transfers of Cash To and From our Subsidiaries

The Company is able to transfer cash (U.S. dollars) to its PRC subsidiaries by: (i) investment – increasing the Company's registered capital in a PRC subsidiary or (ii) a shareholder loan. Other than as follows, to date, its PRC subsidiaries have not transferred any earnings / cash to the Company. 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 / cash needs, including: (i) the funds necessary to pay dividends/cash distributions to its shareholders, (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 to that extent, as well as the others noted below, in their ability to transfer a portion of their net assets to the Company as a dividend.

The PRC has currency and capital transfer regulations that require us to comply with regulations for the movement of capital.

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, and a shareholder loan requires a filing with the state administration of foreign exchange or its local bureau.

With respect to the payment of dividends:

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. these 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 shareholders; the Company does not participate in a Common Welfare Fund; and

the incurrence of debt, specifically the instruments governing such debt, may restrict a subsidiary's ability to pay shareholder dividends or make other cash distributions; the Company is subject to covenants and consent requirements (presently, the Company has all consents necessary).

If, for the reasons noted above, our subsidiaries are unable to pay shareholder dividends and/or make other cash payments to the Company when needed, the Company's ability to conduct operations, make investments and/or 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. A 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. In the event that the FIE's statutory accounts are insufficient to satisfy this requirement, the FIE's shareholders are required to contribute capital required to satisfy the registered capital requirement. Until such contribution of capital is satisfied, the FIE is not allowed to repatriate profits to its shareholders, 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 Company 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 on January 1, 2006, the Company is now 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, 2013 | December 31, 2012 |
|---|---------------------------|-------------------|
| Unrestricted retained earnings | \$43,307,411 | \$ 37,107,107 |
| Restricted retained earnings (surplus reserve fund) | 8,597,232 | 7,766,002 |
| Retained earnings (including surplus reserve fund) | \$51,904,643 | \$ 44,873,109 |

Contractual Obligations

Company's contractual obligations as of June 30, 2013 are as follows:

| Contractual Obligation* | 1 year or less | More than 1 year | See Note (for details) |
|-------------------------|----------------|------------------|------------------------|
| Bank loans payable | \$13,271,400 | \$8,092,317 | 14 |
| Trust loans payable | 31,964,653 | - | 14 |
| Cinda note payable | 3,766,694 | - | 15 |
| Long term payable | 1,367,192 | 3,078,793 | 14 |
| Total | \$50,369,939 | \$11,171,110 | |

*does not includes interest

Starting from July 2013, the Company started collecting payments from a second Shanxi Datong BPRT system, which was completed and sold in June 2013, and, by the end of 2013, the other two systems under Shanxi Datong project are expected to be put into operation and generate additional revenue for the Company.

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 get loans and, 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.

Off-Balance Sheet Arrangements

We have not entered into any 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.

Commitments

Shanxi Datong Coal Group Power Generation Projects

In February 2011, Xi'an TCH signed a contract with Shanxi Datong Coal Group Steel Co., Ltd (the "Shanxi Datong") to recycle gas and steam from groups of blast-furnaces and converter of Shanxi Datong's metal refining plants to generate power. According to the contract, Xi'an TCH will install two 3MW BPRT, one 15MW WGPG and two 1MW steam power generation systems, with a total of 23MW power capacity for an estimated total investment of \$27.45 million (RMB 180 million). The lease term is 30 years. During the term of the lease, Shanxi Datong will pay a service fee to Xi'an TCH. The service fee is based on an average of 8,000 electricity-generating hours per year and \$0.05 (RMB 0.33) per kilowatt hour ("kWh") for the first 5 years from the completion of each power generation station. For each of the leases, at the 6th year, 11th year and 21st year thereafter, the rate will be RMB 0.3 kWh, 0.27 kWh and 0.25 kWh, respectively. After 30 years, the units will be transferred to Shanxi Datong without any charge.

As of June 30, 2013, the two 3 MW BPRT systems were completed, and the Company paid \$13.22 million for the remaining Shanxi Datong Coal Group Power Generation project. The Company is committed to pay an additional \$5.50 million for completion of the entire Shanxi Datong Coal Group Power Generation project. The Company expects to complete the project by the end of 2013.

Jilin Ferroalloys Power Generation Projects

In May 2013, Xi'an TCH signed a contract with Sinosteel Jilin Ferroalloys Co., Ltd. ("Jitie") to build furnace gas waste heat power generation systems for electricity generation from recycled heat and steam from groups of ferroalloy furnaces and electric furnaces ("Jitie project"). According to the contract, Xi'an TCH will install a 7.5 MW and a 3 MW turbine power generation system, with a total of 10.5 MW power capacity for an estimated total investment of \$9.71 million (RMB 60 million). The lease term is 24 years. During the term of the lease, Jitie will pay a service fee to Xi'an TCH based on the actual generating capacity with a minimum service fee per month of \$0.3 million (RMB 1.8 million). The actual generating capacity is based on an average of 7,200 and 5,760 electricity-generating hours per year for 7.5 MW and 3 MW systems, respectively, and \$0.07 (RMB 0.42) per kilowatt hour ("kWh") as the settlement price. Xi'an TCH will be responsible for the systems' operation and will have ownership of the power generation systems. On May 12, 2013, Xi'an TCH entered into an agreement with Xi'an Huaxin Energy Tech Co., Ltd (the contractor for construction) for the construction of Jitie projects. The project was scheduled to be completed 12 months from construction commencement and will be done in the model of Energy Management Contract" (EMC). Xi'an has paid \$4.86 million and is committed to pay additional \$4.86 million for Jitie project.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Exchange Rate Risk

Our operations are conducted mainly in the PRC. As such, our earnings are subject to movements in foreign currency exchange rates when transactions are denominated in RMB, which is our functional currency. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies.

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 as of June 30, 2013, 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, 2013, 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

The Company is not currently involved in any material pending legal proceedings.

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, 2012 as supplemented by the risk factors set forth in our Quarterly Report of Form 10-Q for fiscal quarter ended March 31, 2013. 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 and our first quarter Form 10-Q. 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.

None

Item 5. Other Information

None

Item 6. Exhibits

| Exhibit Number | Description |
|-----------------------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a).* |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a).* |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350.* |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350.* |
| 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 with the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2013

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 14, 2013 /s/ Guohua Ku
Guohua Ku
Chairman of the Board and Chief Executive Officer

Date: August 14, 2013 /s/ David Chong
David Chong
Chief Financial Officer, Principal Accounting Officer and Secretary

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