

CleanTech Innovations, Inc.  
Form 10-Q  
January 06, 2014

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

\_\_\_\_\_  
FORM 10-Q  
\_\_\_\_\_

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

For the quarterly period ended June 30, 2013

OR

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

Commission file number: 001-35002

CLEANTECH INNOVATIONS, INC.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of incorporation  
or organization)

98-0516425  
(IRS Employer Identification No.)

C District, Maoshan Industry Park,  
Tieling Economic Development Zone,  
Tieling, Liaoning Province, China  
(Address of principal executive offices)

112616  
(Zip Code)

(86) 0410-6129922  
(Registrant's telephone number, including area code)

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

YES  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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a 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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 24,982,822 shares of common stock outstanding as of December 31, 2013.

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EXPLANATORY NOTE

On August 15, 2012 CleanTech Innovations, Inc. suspended reporting under the Exchange Act of 1944, as amended, after evaluating the benefits to U.S. shareholders in light of the ongoing costs of such reporting. The company had sought to become a NASDAQ listed company in order to facilitate access to capital, develop a substantial institutional and retail investor base and access a liquid, fair and orderly marketplace for its securities. When the company's common stock was delisted in 2011 pursuant to a decision by NASDAQ Listing Qualifications, the company appealed the decision to the Securities and Exchange Commission which was found in favor of the company on July, 11, 2013. The company is filing this delinquent report on Form 10-Q and other delinquent Exchange Act reports with the Commission in an effort to comply with the listing standards of the NASDAQ Stock Market and relist its common stock thereon.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION

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

- our goals and strategies;
- our expansion plans;
- our future business development, financial conditions and results of operations;
- the expected growth of the market for structural towers for wind turbine products and specialty metal products;
  - our expectations regarding demand for our products;
- our expectations regarding keeping and strengthening our relationships with key customers;
  - our ability to stay abreast of market trends and technological advances;
- our ability to protect our intellectual property rights effectively and not infringe on the intellectual property rights of others;
  - our ability to attract and retain quality employees;
  - our ability to pursue strategic acquisitions and alliances;
    - competition in our industry in China;
- general economic and business conditions in the regions in which we sell our products;
  - relevant government policies and regulations relating to our industry; and
    - market acceptance of our products.

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

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

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

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
JUNE 30, 2013 (UNAUDITED) AND DECEMBER 31, 2012

	2013	2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and equivalents	\$123,466	\$42,996
Restricted cash	272,316	267,689
Accounts receivable, net	2,101,813	2,548,834
Other receivables and deposits	3,478,133	233,570
Retentions receivable	2,287,031	3,297,533
Advances to suppliers	7,879,796	10,727,685
Taxes receivable	135,230	1,790
Inventories, net	8,754,932	8,117,227
Due from shareholder	181,304	89,336
Notes receivable	493,615	850,529
<b>Total current assets</b>	<b>25,707,636</b>	<b>26,177,189</b>
<b>NONCURRENT ASSETS:</b>		
Long term investment	-	95,458
Prepayments	320,631	318,609
Construction in progress	1,927,145	1,894,400
Property and equipment, net	10,529,882	10,626,245
Land use right and patents, net	4,102,562	4,078,260
<b>Total non current assets</b>	<b>16,880,220</b>	<b>17,012,972</b>
<b>TOTAL ASSETS</b>	<b>\$42,587,856</b>	<b>\$43,190,161</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$1,983,368	\$2,376,229
Accrued expenses	2,304,800	1,109,748
Advance from customers	1,959,933	1,385,976
Short term loans	12,963,234	13,295,565
Short term payable, net of unamortized interest	300,715	87,172
<b>Total current liabilities</b>	<b>19,512,050</b>	<b>18,254,690</b>
<b>NONCURRENT LIABILITIES:</b>		
Long term payables, net of unamortized interest	106,103	283,099

Total Liabilities	19,618,153	18,537,789
<b>CONTINGENCIES AND COMMITMENTS</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.00001 par value, 100,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, \$0.00001 par value, 100,000,000 shares authorized, 24,982,822 shares issued and outstanding	250	250
Additional paid in capital	20,649,095	20,649,092
Statutory reserve fund	1,104,138	1,104,138
Accumulated other comprehensive income	3,705,504	3,104,407
Accumulated deficit	(2,489,284 )	(205,515 )
Total stockholders' equity	22,969,703	24,652,372
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$42,587,856</b>	<b>\$43,190,161</b>

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

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
SIX MONTHS ENDED JUNE 30, 2013 AND 2012  
(UNAUDITED)

	Six months ended June 30,		Three months ended June 30,	
	2013	2012	2013	2012
Net sales	\$3,083,648	\$1,756,331	\$2,830,829	\$1,170,475
Cost of goods sold	2,839,545	1,323,911	2,409,444	931,453
Gross profit	244,103	432,420	421,385	239,022
Operating expenses				
Selling	221,687	134,888	173,199	60,071
General and administrative	565,082	1,426,434	326,378	524,211
Bad debt expense	672,474	2,812,817	672,474	1,411,701
Total operating expenses	1,459,243	4,374,139	1,172,051	1,995,983
Loss from operations	(1,215,140 )	(3,941,719 )	(750,666 )	(1,756,961 )
Non-operating income (expenses)				
Interest income	609	4,431	290	1,329
Interest expense	(1,154,737 )	(699,496 )	(705,966 )	(303,616 )
Other income	423,092	23,581	376,810	19,728
Other expenses	(337,593 )	(479,140 )	(294,397 )	(471,610 )
Total non-operating expenses, net	(1,068,629 )	(1,150,624 )	(623,263 )	(754,169 )
Loss before income tax	(2,283,769 )	(5,092,343 )	(1,373,929 )	(2,511,130 )
Income tax expense	-	-	-	-
Net loss	(2,283,769 )	(5,092,343 )	(1,373,929 )	(2,511,130 )
Foreign currency translation gain (loss)	601,097	(146,017 )	507,690	(186,015 )
Comprehensive loss	\$(1,682,672 )	\$(5,238,360 )	\$(866,239 )	\$(2,697,145 )
Basic and diluted weighted average shares outstanding	24,982,822	24,982,822	24,982,822	24,982,822
Basic and diluted loss per share	\$(0.09 )	\$(0.20 )	\$(0.05 )	\$(0.10 )

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

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
SIX MONTHS ENDED JUNE 30, 2013 AND 2012  
(UNAUDITED)

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(2,283,769 )	\$(5,092,343 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	335,119	345,461
Amortization of interest expense of long term payable	29,844	70,055
Increase in allowance for accounts receivable	672,474	2,812,817
Provision for inventory impairment	107,863	-
(Increase) decrease in assets:		
Restricted cash	-	343,412
Accounts receivable	(186,321 )	1,394,371
Retentions receivable	1,056,793	(681,096 )
Notes receivable	367,888	(132,703 )
Other receivables, deposits and prepayments	30,209	284,532
Advances to suppliers	(231,888 )	737,712
Inventories	(600,271 )	(515,358 )
Increase (decrease) in liabilities:		
Accounts payable	(429,579 )	(128,803 )
Accrued expenses	1,188,440	697,736
Advance from customers	544,484	27,097
Taxes payable	(132,070 )	(74,804 )
<b>Net cash provided by operating activities</b>	<b>469,216</b>	<b>88,086</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Construction in process	-	(25,050 )
Acquisition of property & equipment	(12,161 )	(2,490 )
Prepayment for construction	-	(572,344 )
Long term investment receipt	96,134	-
<b>Net cash provided by (used in) investing activities</b>	<b>83,973</b>	<b>(599,884 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments on long term payable	-	(382,091 )
Due from shareholder	(89,517 )	111,540
Advance from shareholder	-	(138,325 )
Repayment of short term loans	(384,535 )	(95,554 )
<b>Net cash used in financing activities</b>	<b>(474,052 )</b>	<b>(504,430 )</b>
<b>EFFECT OF EXCHANGE RATE CHANGE ON CASH &amp; EQUIVALENTS</b>	<b>1,333</b>	<b>(966 )</b>

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NET INCREASE (DECREASE) IN CASH & EQUIVALENTS	80,470	(1,017,194 )
CASH & EQUIVALENTS, BEGINNING OF PERIOD	42,996	1,073,058
CASH & EQUIVALENTS, END OF PERIOD	\$123,466	\$55,864
Supplemental Cash flow data:		
Income tax paid	\$-	\$69,310
Interest paid	\$154,290	\$179,584

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

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2013 (UNAUDITED) AND DECEMBER 31, 2012

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

CleanTech Innovations, Inc., formerly known as Everton Capital Corporation (the “Company” or “CleanTech”), was incorporated on May 9, 2006, in the State of Nevada. Through its wholly owned operating subsidiaries in China, the Company designs, manufactures tests and sells structural towers for on-land and off-shore wind turbines. The Company also manufactures specialty metal products that require advanced manufacturing and engineering capabilities, including bellows expansion joints and connecting bend pipes used for waste heat recycling in steel production, in ultra-high-voltage electricity transmission grids and in industrial pressure vessels.

The Company authorized an 8-for-1 split of its common stock, effective July 2, 2010. Prior to the split, the Company had 5,501,000 shares of common stock issued and outstanding, and, after giving effect to the split, the Company had 44,008,000 shares of common stock issued and outstanding. The effect of the forward stock split was retroactively reflected for all periods presented.

Liaoning Creative Bellows Co., Ltd. (“Creative Bellows”) was incorporated in the PRC province of Liaoning on September 17, 2007. Creative Bellows designs and manufactures bellows expansion joints, pressure vessels, wind tower components for wind turbines and other fabricated metal specialty products. On May 26, 2009, the three individual shareholders of Creative Bellows established Liaoning Creative Wind Power Equipment Co., Ltd. (“Creative Wind Power”). At the end of 2009, the three shareholders transferred their Creative Wind Power shares to Creative Bellows at cost; as a result of the transfer of ownership, Creative Bellows owned 100% of Creative Wind Power. Creative Wind Power markets and sells wind tower components designed and manufactured by Creative Bellows.

The consolidated interim financial information as of June 30, 2013 and for the six and three month periods ended June 30, 2013 and 2012 was prepared without audit, pursuant to the rules and regulations of the Security and Exchange Commission (“SEC”). Certain information and footnote disclosures, which are normally included in consolidated financial statements prepared in accordance with United States Generally Accepted Accounting Principles (“U.S. GAAP”) were not included. The interim consolidated financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, that were filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company’s consolidated financial position as of June 30, 2013, its consolidated results of operations and cash flows for the six and three month periods ended June 30, 2013 and 2012, as applicable, were made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements were prepared in conformity with U.S. GAAP. The Company’s functional currency is the Chinese Yuan Renminbi (“RMB”); however, the accompanying consolidated financial statements were translated and presented in United States Dollars (“USD”). The accompanying consolidated financial statements present the historical financial condition, results of operations and cash flows of the operating companies.

### Going Concern

The Company incurred a net loss of \$2.28 million for the six months ended June 30, 2013. In addition, the Company had loans of \$12.91 million and a \$50,000 promissory note that are past due (See Note 14). The Company has been unable to raise funds from the U.S. markets to pay off these obligations due to the decision by NASDAQ of delisting the Company's common stock. These conditions raise a substantial doubt as to whether the Company may continue as a going concern. However, on July 11, 2013, SEC has reversed the 2011 delisting of the Company's stock on the NASDAQ Stock Market, LLC, and ordered that the Company's stock be listed on the NASDAQ Stock Market. The Company is planning to negotiate with its lenders to extend the maturity dates of its past due loans for another 12 months and to seek additional financing from local banks in the PRC. The Company will also seek to improve its cash flows from operations by implementing cost control measures and reducing inventory purchases.

### Principles of Consolidation

The consolidated financial statements include the accounts of CleanTech and its wholly owned subsidiaries, Creative Bellows and Creative Wind Power. All intercompany transactions and account balances were eliminated in consolidation.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2013 (UNAUDITED) AND DECEMBER 31, 2012

Use of Estimates

In preparing financial statements in conformity with U.S. GAAP, management makes estimates and assumptions that effect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates include the recoverability of long-lived assets and the valuation of inventories. Actual results could differ from those estimates.

Cash and Equivalents

Cash and equivalents include 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 this purchase date

Restricted Cash

Restricted cash consists of a percentage of sales deposited by the Company into its bank accounts according to contract terms, which serves as a contract execution and product delivery guarantee. The restriction is released upon customer acceptance of the product.

Accounts and Retentions Receivable

The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Past due receivables are determined based on contractual payment terms specified in the contract. The Company does not anticipate any significant credit risk because the majority of its customers are large, well-capitalized state-owned and publicly traded utility and industrial companies with stable operations. Based on its historical collection activity, the Company had allowances for bad debts of \$5,105,160 and \$4,350,671 at June 30, 2013 and December 31, 2012, respectively.

At June 30, 2013 and December 31, 2012, the Company had retentions receivable for product quality assurance of \$2,287,031 and \$3,297,533, respectively. The retention generally is 10% of the sales price with a one-year term, but no later than the termination of the warranty period. The Company has not encountered any significant collectability issues with respect to the retentions receivable.

Inventories

The Company's inventories are valued at the lower of cost or market, with cost determined on a weighted average basis. The Company compares the cost of inventories with market value and an allowance is made to write down the inventories to their market value, if lower.

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

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retired or otherwise disposed, 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 for substantially all assets with 5% salvage value and estimated lives as follows:

Buildings	40	Years
Machinery	5	15 Years
	-	
Vehicles	5	Years
Office equipment	5	Years
Testing equipment	10	Years

Land Use Rights

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

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
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Revenue Recognition

The Company's revenue recognition policies are in compliance with SEC Staff Accounting Bulletin ("SAB") 104 (codified in FASB ASC Topic 605). Sales revenue, including the final 10% of the purchase price, is recognized after delivery is complete, customer acceptance of the product occurs and collectability is reasonably assured. Customer acceptance occurs after the customer puts the product through a quality inspection, which normally is completed within one to two weeks from customer receipt of the product. In case of sales contracts with FOB shipping terms, the customer is responsible for cost of freight and insurance and revenue is recognized when products are delivered to the carrier. In case of sales contracts with FOB destination terms, the Company is responsible for the cost of freight and insurance and revenue is recognized when customer acceptance is received. The customer is responsible for installation and integration of our component products into its end products. Payments received before satisfaction of all relevant criteria for revenue recognition are recorded as unearned revenue or advances from customers. Unearned revenue or advances from customers consists of payments received from customers prior to customer acceptance of the product.

The Company's standard payment terms with its wind tower customers generally provide that 10% of the purchase price is due upon the Company's deposit of restricted cash into a bank account as a contract guarantee, 20% upon the Company's purchase of raw material for the order, 10% upon delivery of the base ring component of the wind towers, 30% upon delivery of the wind tower tube sections and 20% upon customer inspection and acceptance of the product, which customers normally complete within 1-2 weeks after delivery. As a common practice in the manufacturing business in PRC, payment of the final 10% of the purchase price is due no later than the termination date of the product warranty, which can be up to 12 months from the customer acceptance date. The final 10% of the purchase price is recognized as revenue upon customer acceptance of the product. For the Company's bellows expansion joints and pressure vessels, payment terms are negotiated on a case-by-case basis and these payment percentages and terms may differ for each customer.

Sales revenue is the invoiced value of goods, net of value-added tax ("VAT"). The Company's products sold and services provided in China are subject to VAT of 17% of the sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing the finished product. The Company recorded VAT payable and VAT receivable net of payments in the financial statements. The VAT tax return is filed offsetting the payables against the receivables.

Warranties

The Company offers a product warranty to its customers of up to 12 months depending on the terms negotiated with each customer. During the warranty period, the Company will repair or replace defective products free of charge. The Company commenced production in 2009 and as of June 30, 2013, the Company accrued \$8,568 in warranty expense. The Company implemented internal manufacturing protocols designed to ensure product quality beginning from the receipt of raw materials to the final inspection at the time products are shipped. The Company monitors warranty claims and accrues for warranty expense accordingly, using ASC Topic 450 to account for its standard warranty.

The Company provides its warranty to all customers and does not consider it an additional service; rather, the warranty is considered an integral part of the product's sale. There is no general right of return indicated in the contracts or purchase orders. If a product under warranty is defective or malfunctions, the Company is responsible for fixing it or replacing it with a new product. The Company's products are its only deliverables.

The Company's warranty reserve activity for the six months ended June 30, 2013 and year ended December 31, 2012, is as follows:

	2013		2012	
Balance at beginning of period	\$	9,790	\$	11,094
Foreign currency translation loss		(1,222)		(1,304)
Actual costs incurred				-
Ending balance (accrued expense)	\$	8,568	\$	9,790

After the expiration of the warranty period, the Company charges for after-sales services on its products. Such revenue is recognized when the service is provided. For the six months ended June 30, 2013 and years ended December 31, 2012, the Company had no after-sales services income. The warranty reserve is included in accrued expense (Note 13).

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2013 (UNAUDITED) AND DECEMBER 31, 2012

Cost of Goods Sold

Cost of goods sold (“COGS”) consists primarily of material, labor and related overhead, which is attributable to the products, and other indirect costs that benefit all products. Write-down of inventory to lower of cost or market is also recorded in COGS.

Research and Development

Research and development (“R&D”) costs are related primarily to the Company’s development and testing of its new technologies used to manufacture its bellows-related products. R&D costs are expensed as incurred. For the six months ended June 30, 2013 and 2012, R&D was \$106,187 and \$282,510, respectively, and was included in general and administrative expenses. For the three months ended June 30, 2013 and 2012, R&D was \$59,674 and \$233,620, respectively.

Shipping and Handling Costs

Shipping and handling costs for delivery of finished goods are included in selling expenses. During the six months ended June 30, 2013 and 2012, shipping and handling costs were \$87,408 and \$37,969, respectively. During the three months ended June 30, 2013 and 2012, shipping and handling costs were \$61,486 and \$36,252, respectively.

Basic and Diluted Earnings per Share (“EPS”)

Basic EPS is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed similar to basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if all the potential common shares, warrants and stock options had been issued and if the additional common shares were dilutive. Diluted EPS are based on the assumption that all dilutive convertible shares and stock options and warrants were converted or exercised. Dilution is computed by applying the treasury stock method for the outstanding options and warrants, and the if-converted method for the outstanding convertible preferred shares. Under the treasury stock method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Under the if-converted method, convertible outstanding instruments are assumed to be converted into common stock at the beginning of the period (or at the time of issuance, if later).

The warrants and options to purchase up to 2,821,310 shares of common stock were anti-dilutive during the six and three months ended June 30, 2013 and 2012.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist primarily of accounts and other receivables and advances to suppliers. The Company does not require collateral or other security to support these receivables. The Company conducts periodic reviews of its clients’ financial condition and customer payment practices to minimize collection risk on accounts receivable.

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

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, as well as by the general state of the PRC economy.

#### Statement of Cash Flows

In accordance with SFAS No. 95, "Statement of Cash Flows," codified in FASB ASC Topic 230, cash flows from the Company's operations are calculated based upon local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows may not necessarily agree with changes in the corresponding balances on the balance sheet.

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Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with SFAS No. 123R, “Share-Based Payment, an Amendment of FASB Statement No. 123” (codified in FASB ASC Topics 718 and 505). The Company recognizes in the income statement the grant-date FV of stock options and other equity-based compensation issued to employees and non-employees.

Foreign Currency Translation and Transactions

The accompanying consolidated financial statements are presented in USD. The Company’s functional currency is RMB, which is translated into USD for balance sheet accounts using the current exchange rates in effect as of the balance sheet date and for revenue and expense accounts using the average exchange rate during the period. The translation adjustments are recorded as a separate component of stockholders’ equity, captioned accumulated other comprehensive income (loss). Gains and losses resulting from transactions denominated in foreign currencies are included in other income (expense) in the consolidated statements of operations.

The RMB to USD exchange rates in effect as of June 30, 2013 and December 31, 2012, were \$1 = RMB 6.1787 and \$1 = RMB 6.2855, respectively. The average RMB to USD exchange rates in effect for the six months ended June 30, 2013 and 2012, were \$1 = RMB 6.2413 and \$1 = RMB 6.3074, respectively. The exchange rates used in translation from RMB to USD were published by the People’s Bank of China.

Comprehensive Income (Loss)

The Company uses SFAS No. 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. Comprehensive income (loss) for the six and three months ended June 30, 2013 and 2012, included net income (loss) and foreign currency translation adjustments.

Segment Reporting

SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information” (codified in FASB ASC Topic 280), requires use of the “management approach” model for segment reporting. The management approach model is based on the way a company’s management organizes segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure or any other manner in which management disaggregates a company.

Management determined the Company’s product lines – wind towers, bellows expansion joints and pressure vessels – constitute a single reportable segment under ASC 280. The Company operates exclusively in one business: the design and manufacture of highly engineered metal components for heavy industry. The manufacturing processes for each of the Company’s products, principally the rolling and welding of raw steel materials, make uses of the same pool of production workers and engineering talent for design, fabrication, assembly and testing. The Company’s products are characterized and marketed by their ability to withstand temperature, pressure, structural load and other environmental factors. The Company’s products are used by major electrical utilities and large-scale industrial companies in China specializing in heavy industry, and the Company’s sales force sells its products directly to these companies, which

utilize the Company's components in their finished products. All of the Company's long-lived assets for production are located in its facilities in Tieling, Liaoning Province, China, and operate within the same environmental, safety and quality regulations governing industrial component manufacturing companies. The Company established its subsidiary, Creative Wind Power, solely to market and sell the Company's wind towers, which constitute the structural support cylinder for an industrial wind turbine installation. Management believes that the economic characteristics of the Company's product lines, specifically costs and gross margin, will be similar as production increases and labor continues to be shared across products.

As a result, management views the Company's business and operations for all product lines as a blended gross margin when determining future growth, return on investment and cash flows. Accordingly, management concluded the Company had one reportable segment under ASC 280 because: (i) all of the Company's products are created with similar production processes, in the same facilities, under the same regulatory environment and sold to similar customers using similar distribution systems; and (ii) gross margins of all product lines have been converging and should continue to converge.

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Following is a summary of sales by products for the six months ended June 30, 2013 and 2012:

	2013	2012
Bellows expansion joints and related	\$ 324,999	\$ 630,368
Pressure vessels	555,714	1,010,887
Wind towers	905,466	165
Other - resale of raw materials	1,297,469	114,911
	\$ 3,083,648	\$ 1,756,331

Following is a summary of sales by products for the three months ended June 30, 2013 and 2012:

	2013	2012
Bellows expansion joints and related	\$ 205,850	\$ 167,718
Pressure vessels	555,714	935,003
Wind towers	905,466	165
Other - resale of raw materials	1,163,799	67,589
	\$ 2,830,829	\$ 1,170,475

### 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 is no recently issued accounting standards not yet adopted that would have a material effect on the Company's interim consolidated financial statements.

### 3. OTHER RECEIVABLES AND DEPOSITS

Other receivables and deposits consisted of the following at June 30, 2013 and December 31, 2012:

	2013	2012
Deposits for contract bids	\$ 57,860	\$ 132,008

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Advance to employees	153,057	51,453
Other	3,267,216	50,109
Total	\$ 3,478,133	\$ 233,570

As of June 30, 2013, others of \$3,267,216 mainly consisted of the receivables from suppliers whom the Company previously prepaid for raw material purchases but the purchase orders were later cancelled by the Company. The Company collected \$2,133,700 from the suppliers in August and September 2013, and expected to collect the remaining payments by the end of 2013.

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## 4. ADVANCES TO SUPPLIERS

Advances to suppliers mainly consisted of prepayments to suppliers for raw materials which were mainly comprised of steel.

## 5. INVENTORIES

Inventories consisted of the following at June 30, 2013 and December 31, 2012:

	2013	2012
Raw materials	\$ 1,980,093	\$ 1,472,427
Finished goods	2,827,626	3,709,225
Work in process	4,269,141	3,144,928
Less: allowance for inventory impairment	(321,928)	(209,353)
Total	\$ 8,754,932	\$ 8,117,227

## 6. DUE FROM SHAREHOLDER

As of June 30, 2013 and December 31, 2012, the Company advanced \$181,304 and \$89,336, respectively, to the Company's CEO, who is also a shareholder of the Company, for the CEO to negotiate and purchase certain raw materials, pay the expenses of bidding the contracts on Company's behalf, as well as the advance for the CEO's business trip.

## 7. NOTES RECEIVABLE – BANK ACCEPTANCES

The Company sold goods to its customers and received commercial notes (bank acceptances) from them in lieu of payment for accounts receivable. The Company discounted these notes with a bank or endorsed notes to vendors for payment of its obligations or to get cash from third parties. Most of the commercial notes have a maturity of less than six months. These notes receivable are with recourse and the Company is contingently liable to make the payment to the endorsee in case of a default. As of June 30, 2013, the Company had notes receivable of \$367,140 that were endorsed to vendors as payments for the Company's obligation (contingent liability), and \$16,185 that were discounted for cash.

## 8. LONG-TERM INVESTMENT

On June 10, 2009, Creative Bellows made an investment with a credit union and purchased 600,000 credit union shares for \$95,000 (RMB 600,000). As a result of this investment, Creative Bellows became a 0.57% shareholder in the credit union. The Company accounted for this investment using the cost method. During the three months ended June 30, 2013, the Company cancelled the investment, and received the full refund of \$95,000 (RMB 600,000).

## 9. PREPAYMENTS

Noncurrent portion of the prepayments mainly was a prepaid land occupancy fee paid to the inhabitants of the land on which the Company plans to construct a manufacturing plant. Currently, the Company amortizes prepaid rental over

50 years according to the terms of the lease agreement.

#### 10. CONSTRUCTION IN PROGRESS

At June 30, 2013 and December 31, 2012, the Company had construction in progress of \$1,927,145 and \$1,894,400, respectively, to rebuild and improve its workshop ground and road and to build wind test towers. Total construction cost of the workshop and road project is approximately \$1.94 million. As of June 30, 2013, the Company needs to pay an additional \$0.04 million to complete it.

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## 11. PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following at June 30, 2013 and December 31, 2012:

	2013	2012
Buildings	\$ 8,589,274	\$ 8,443,329
Equipment and machinery	3,405,830	3,335,885
Vehicle	52,924	52,025
Office equipment	105,498	103,706
Total	12,153,526	11,934,945
Accumulated depreciation	(1,623,644)	(1,308,700)
Net value	\$ 10,529,882	\$ 10,626,245

Depreciation for the six months ended June 30, 2013 and 2012 was \$289,391 and \$283,920, respectively. Depreciation for the three months ended June 30, 2013 and 2012, was \$145,217 and \$143,114, respectively.

## 12. INTANGIBLE ASSETS

Intangible assets consisted of land use right and patents. All land in the PRC is government-owned and cannot be sold to any individual or company. However, the government grants the user a "land use right" to use the land. The Company has the right to use the land for 50 years and amortizes the right on a straight-line basis over 50 years.

The Company was granted an exclusive license to use a production method patent until December 31, 2016, for lead-free soft solder with mischmetal from the Shenyang Industry University. The Company paid a one-time use of technology fee of RMB 100,000 (\$15,887).

Intangible assets as of June 30, 2013 and December 31, 2012 were as follows:

	2013	2012
Land use right	\$ 4,522,968	\$ 4,446,116
Patents	16,185	15,910
Total	4,539,153	4,462,026
Accumulated amortization	(436,591)	(383,766)
Net	\$ 4,102,562	\$ 4,078,260

Amortization of intangible assets for the six months ended June 30, 2013 and 2012 was \$45,728 and \$61,541, respectively. Amortization of intangible assets for the three months ended June 30, 2013 and 2012 was \$30,436 and \$22,624, respectively. At June 30, 2013, annual amortization for the next five years was expected to be as follows:

Year	Amount
2014	\$ 91,000
2015	91,000
2016	91,000
2017	91,000
2018	91,000

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Thereafter	3,647,562
Total	\$ 4,102,562

As of June 30, 2013, the Company is in the process of acquiring a land use right in the Liaoning Province Tieling Economic and Technological Development Zone for which a land use right deposit of \$0.4 million was made to Tieling Yinzhou Industrial Park Management Committee and Tieling Economic Development Zone Non-Tax Revenue Bureau. The deposit of the land use right was transferred into intangible assets during the first quarter of 2012; however, the Company has not obtained the land use right as of this report date.

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## 13. ACCRUED EXPENSES

Accrued expenses at June 30, 2013 and December 31, 2012 were as follows:

	2013	2012
Payroll-related	\$ 199,134	\$ 34,634
Warranty (note 2)	8,568	9,790
Other	273,859	110,928
Accrued interest	1,422,431	499,495
Accrued outsourcing labor cost	-	54,093
Accrued legal expense	400,808	400,808
Total	\$ 2,304,800	\$ 1,109,748

As of June 30, 2013, the Company had \$400,808 accrued legal expense for unpaid legal fees to a law firm in connection with the representation of the Company in its lawsuit against the NASDAQ Stock Market, LLC and NASDAQ OMX Group (See Note 24).

## 14. SHORT-TERM LOANS

On September 13, 2010, the Company borrowed \$1,827,050, \$953,243 and \$556,059 from three different credit unions. Each loan bore interest of 7.2% and each was to mature on September 12, 2011. The Company extended the maturity date of the loans through an agreement with one of the credit unions. Pursuant to this agreement, the Company was required to pay \$317,415 (RMB 2,000,000) by October of 2011, with the remaining balance to be paid by June 2012. However, the Company did not make the payment of \$317,415 (RMB 2,000,000) as per the agreement and, as such, the extension of maturity date was not granted. As of June 30, 2013, all three loans were in default and an additional 3.6% interest on the remaining principal amount of the loans was charged for the overdue period. These loans were collateralized by one of the Company's buildings and its land use right. During the three months ended June 30, 2013, the Company repaid \$384,535 as disclosed in the below table.

On December 13, 2010, the Company entered into a loan with a lender for \$10 million. At the Lender's option, the principal amount of the note and all interest thereon shall be paid in either USD or RMB at an exchange rate of RMB 6.90 to USD 1.00 if paid on or before March 1, 2012, and thereafter at an exchange rate of RMB 6.30 to USD 1.00 to the Lender or any designee of Lender as provided to the Company in writing by Lender. The loan bore interest of 10% payable in advance at the beginning of each quarter with a maturity of March 1, 2012. The loan was amended to mature on March 1, 2013, and to decrease the interest rate to 8.5%, effective March 1, 2012, which interest shall be payable quarterly in advance. As of June 30, 2013, the Company was in default on this loan and the interest, accordingly, the Company accrued interest, from the date of the Default, at the rate per annum of the lesser of 24% and the maximum applicable legal rate per annum. The Company currently uses 24% per annum as default interest rate and had interest payable of \$1.39 million as of June 30, 2013. After August 13, 2013, the interest rate on the \$10 million loan will be 8.5%.

Through a new Promissory Note Agreement entered with the same lender on August 17, 2013, this default loan became payable upon Note-holder's request. The Promissory Note entered on August 17, 2013 along with an Escrow Agreement was for a Line of Credit available to the Company of up to \$10 million. The lender deposited the loan amount into an escrow account, and the escrow agent shall disburse some or all of the deposit from time to time as

directed in writing by the lender for advancing the Company to pay expenses that are approved by the lender. The applicable interest rate for this line of credit is 3% per annum during the first 6 months following each advance, and 0% thereafter, to be paid on the first day of each month, with maturity upon Note-holder's request. The promissory note has a default rate of 24% per annum.

On December 14, 2011, the Company entered into a 3% promissory note with a lender for \$50,000, maturing on February 1, 2012, for the payment of its legal expenses. As of June 30, 2013, the Company had accrued interest of \$4,438 on this note. The note is past due with default interest at 6% to be accrued subsequent to February 1, 2012.

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At June 30, 2013 and December 31, 2012, the short-term loans consisted of the following:

	2013		2012
Credit Union 1	\$ 1,764,125	\$	1,734,150
Credit Union 2	971,078		954,578
Credit Union 3	178,031		556,837
Promissory Note	50,000		50,000
Loan of U.S. Parent	10,000,000		10,000,000