

WUHAN GENERAL GROUP (CHINA), INC
Form 10-K
April 06, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2011

or

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file number 001-34125

WUHAN GENERAL GROUP (CHINA), iNC.

(Exact Name of Registrant as Specified in Its Charter)

Nevada	84-1092589
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

Canglongdao Science Park of Wuhan East Lake Hi-Tech
Development Zone
Wuhan, Hubei, People's Republic of China
(Address of Principal Executive Offices)

430200
(Zip Code)

86-27-5970-0069
(Registrant's Telephone Number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.0001 per share	The NASDAQ Stock Market LLC

Securities registered under Section 12(g) of the Exchange Act: None.

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

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 Act). Yes No

As of June 30, 2011, the aggregate market value of the registrant's common stock held by non-affiliates was approximately \$7,901,774 based on the closing sale price as quoted on the NASDAQ Capital Market.

As of April 5, 2012, the registrant had a total of 32,505,000 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the company's Proxy Statement for its 2012 Annual Meeting of Stockholders are incorporated by reference into Part III.

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SIGNATURES

Cautionary Statement Regarding Forward-Looking Statements

The information contained in this report includes some statements that are not purely historical fact and that are “forward-looking statements” as defined by the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include, but are not limited to, statements regarding our management’s expectations, hopes, beliefs, intentions or strategies regarding the future, including our financial condition, results of operations, available liquidity, ability to refinance outstanding debt, and our ability to collect on our accounts receivable. The words “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “may,” “projects,” “should,” and similar expressions, or the negatives of these terms, identify forward-looking statements.

The forward-looking statements contained in this report are based on our current expectations and beliefs concerning future developments. There can be no assurance that future developments actually affecting us will be those anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results to be materially different from those expressed or implied by these forward-looking statements, including the following:

- vulnerability of our business to general economic downturn;
- our ability to obtain financing on favorable terms;
- our ability to comply with the covenants and other terms of our loan agreements;
- establishing our business segment relating to industrial parts and machinery equipment;
- operating in the PRC generally and the potential for changes in the laws of the PRC that affect our operations including tax law;
- remediating material weaknesses in our internal control over financial reporting;
- our failure to meet or timely meet contractual performance standards and schedules;
- our dependence on the steel and iron markets;
- exposure to product liability and defect claims;
- our ability to obtain all necessary government certifications and/or licenses to conduct our business;
- the cost of complying with current and future governmental regulations and the impact of any changes in the regulations on our operations; and
- the other factors referenced in this report.

These risks and uncertainties, along with others, are also described in the Risk Factors section in Part I, Item 1A of this Form 10-K. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws.

PART I

Item 1. Business.

We obtained statistical data, market data and other industry data and forecasts used throughout, or incorporated by reference in, this report from market research, publicly available information and industry publications. Industry publications generally state that they obtain their information from sources that they believe to be reliable, but they do not guarantee the accuracy and completeness of the information.

Overview

Wuhan General Group (China), Inc. (the “Company”) is a holding company whose primary business operations are conducted through our wholly owned subsidiary, Universe Faith Group Limited (“UFG”), which has no operations of its own and only serves to hold our Chinese operating subsidiaries, Wuhan Blower Co., Ltd. (“Wuhan Blower”), Wuhan Generating Equipment Co., Ltd. (“Wuhan Generating”) and Wuhan Sungreen Environment Protection Equipment Co., Ltd. (“Wuhan Sungreen”), which we formerly referred to as Wuhan Xingelin Machinery Equipment Manufacturing Co., Ltd., or Wuhan Xingelin. Wuhan Blower is a manufacturer of industrial blowers that are principally components of steam-driven electrical power generation plants. Wuhan Generating manufactures industrial steam and water turbines, which also are principally used in electrical power generation plants. Wuhan Sungreen manufactures silencers, connectors and other general parts for industrial blowers and electrical equipment, and it produces general machinery equipment. Wuhan Blower, Wuhan Generating and Wuhan Sungreen conduct all of their operations in the People’s Republic of China, which we refer to in this report as PRC or China. Prior to our acquisition of UFG in February 2007, we were a publicly held shell company with no operations other than efforts to identify suitable parties for a merger transaction.

Our Corporate History

The Company was incorporated on July 19, 1988 under the laws of the State of Colorado as Riverside Capital, Inc. On February 28, 1989, Riverside Capital completed a public offering of 20,500,000 units (consisting of common stock and warrants) at an offering price of \$0.01 per unit. Riverside Capital engaged in various business endeavors, and on March 18, 1992, acquired 100% of the outstanding shares of United National Film Corporation. At that time, we changed our name to United National Film Corporation. We were not successful in the film business, and in June 2001, we suspended all business activities and became a “reporting shell corporation.” As such, we had no operations other than maintaining our public company status and searching for a suitable party with which to execute a reverse merger transaction, in which a previously private company takes on our public company status. In October 2006, we changed our state of incorporation from Colorado to Nevada.

On February 7, 2007, we completed a share exchange transaction, in which we issued to Fame Good International Limited (“Fame”), as the sole stockholder of UFG, 17,912,446 newly issued shares of our common stock in exchange for all of the issued and outstanding capital stock of UFG held by Fame. As a result, UFG became our wholly owned subsidiary, Fame became our controlling stockholder and the management team of Wuhan Blower replaced our prior management. Prior to the share exchange transaction, we had no relationship with Fame, UFG and its subsidiaries. On March 13, 2007, the Company changed its name from “United National Film Corporation” to “Wuhan General Group (China), Inc.”

Prior to the share exchange transaction, we had 1,800,000 shares of common stock outstanding. Following the closing of the share exchange transaction, we had 19,712,446 shares of common stock outstanding. As of April 5, 2011, we had 32,505,000 shares of common stock outstanding.

Background and History of UFG and Wuhan Blower

UFG was incorporated in the British Virgin Islands in August 2006. Until the share exchange transaction in February 2007, UFG was a wholly owned subsidiary of Fame, also a BVI company and now our controlling stockholder. Our Chairman of the Board, Mr. Xu Jie, acquired control of Fame, and Fame acquired control of UFG, in late August 2006. Neither Fame nor UFG had any active business operations until UFG acquired Wuhan Blower in September 2006.

Wuhan Blower was founded in 1958 as the Wuhan Blower Company, a State-Owned Enterprise (“SOE”) and became one of the largest manufacturers of industrial blowers in central and southwest China. In 2004, Mr. Xu purchased the company with the intention of making changes to its management structure, employee utilization, plant location and general operations which would transform it from a traditional Chinese SOE into a modern, efficient operating company. Mr. Xu relocated the company to the East Lake Hi-Tech Development Zone in Wuhan, with much improved access to railroads, waterways and roads necessary for the transportation of its products, and constructed a new headquarters, research and development, and manufacturing facilities at this location.

On January 9, 2007, Wuhan Blower completed its acquisition of Wuhan Generating, a manufacturer of water and steam turbines, which is a complementary business to that of Wuhan Blower. We completed the construction of a new turbine manufacturing facility in 2009 for Wuhan Generating. We have installed a portion of the customized equipment in this facility and have begun producing steam turbines from this facility. We have purchased additional customized equipment for this facility and will install this equipment in order to increase our production capacity.

On December 25, 2008, we acquired certain assets to establish our newest subsidiary, Wuhan Sungreen. This is described in more detail below in “Overview – Establishment of Wuhan Sungreen.”

We are located in Wuhan, the capital of China’s Hubei Province and one of the ten largest cities in China. Hubei is centrally located and is a key player in the Chinese automotive, metallurgy, machinery, power generation, textiles and high-tech industries. Wuhan is one of the major university cities in the PRC, providing a highly educated workforce for the area’s industries.

February 2007 Private Placement

Also on February 7, 2007, we completed a private placement transaction in which we issued to nine institutional investors an aggregate of 10,287,554 shares of our newly created Series A Convertible Preferred Stock (“Series A Preferred Stock”) at a price of \$2.33 per share for gross proceeds of \$23,970,000. The Series A Preferred Stock is convertible into shares of our common stock on a 1-for-1 basis. The holders of our Series A Preferred Stock are not required to pay a conversion price or any other consideration in order to convert Series A Preferred Stock into common stock. The Series A Preferred Stock is entitled to a dividend equal to 5% per annum, which accrue quarterly. We must pay any unpaid dividends on our Series A Preferred Stock before paying dividends on our common stock.

Except with respect to specified transactions that may affect the Series A Preferred Stock and except as otherwise required by Nevada law, the Series A Preferred Stock has no voting rights. Of our outstanding shares of Series A Preferred Stock, 32.5% was converted into 3,343,560 shares of common stock in 2008 and none were converted in 2009 and 2010. The remaining shares of our Series A Preferred Stock will convert automatically into our common stock if the trading price and volume of our common stock reach certain levels. In the event of our liquidation, the holders of Series A Preferred Stock shall be entitled to receive, out of our assets available for distribution to stockholders, an amount equal to \$2.33 per share plus any accrued and unpaid dividends before any payment can be made to the holders of our common stock.

In the private placement, we also issued three series of common stock purchase warrants to the nine institutional investors - Series A, J and B.

The Series J Warrants had an exercise price of \$2.33 per share and expired on November 7, 2008. As described in more detail below in “Overview – Creation of Series B Preferred Stock” in this Part I, Item 1, we amended the terms of the Series J Warrants in September 2008 so that the warrants became exercisable for Series B Convertible Preferred Stock (“Series B Preferred Stock”) rather than common stock. Prior to the expiration date, a portion of the Series J Warrants was exercised for a total of 6,369,078 shares of Series B Preferred Stock.

The Series A and Series B warrant holders sold warrants to purchase an aggregate of 3,913,905 shares of common stock to Fame under a Warrant Purchase Agreement entered into by and among the Company, Fame and certain warrant holders (the “Warrant Purchase Agreement”), and exchanged warrants to purchase an aggregate of 9,865,222 shares of common stock with the Company under a Warrant Exchange Agreement entered into by and among the Company and certain warrant holders (the “Series A and B Warrant Exchange Agreement”). The warrant purchase closed on December 13, 2010, and the warrant exchange with the Series A and Series B warrant holders, other than Fame, closed on the same date. In total, the Company issued 4,932,609 shares of common stock in connection with the recapitalization of the Series A and Series B warrants. The warrant exchange with Fame closed on January 21, 2011. For more information, see “– Warrant Recapitalization.”

As partial consideration for services rendered by 1st BridgeHouse Securities, LLC (“1st BridgeHouse”), the placement agent for the February 2007 private placement, we agreed to issue warrants to purchase common stock to 1st BridgeHouse. This right is represented by Series C, AA, BB and JJ warrants originally issued to 1st BridgeHouse. The Company entered into a Warrant Exchange Agreement with Fame and all of the Series C, AA, BB and JJ warrant holders (the “Series C, AA, BB and JJ Warrant Exchange Agreement”) pursuant to which the Company exchanged all of the outstanding Series C, AA, BB and JJ warrants for the issuance by the Company of (i) 1.372921615 shares of the Company’s common stock per share of Series C warrant stock; (ii) 0.8203 shares of the Company’s common stock per share of Series AA and Series BB warrant stock; and (iii) 0.8288 shares of the Company’s common stock per share of Series JJ warrant stock. In connection with the closing of this transaction, the Company issued an additional 4,177,393 shares of common stock in exchange for Series A, B, C, AA, BB and JJ warrants. The warrant exchange with the Series C, AA, BB and JJ warrant holders closed on January 21, 2011. For more information, see “– Warrant Recapitalization.”

Creation of Series B Preferred Stock

On September 5, 2008, the Company entered into an Agreement to Amend Series J Warrants of the Company with holders of warrants exercisable for a majority of the shares of warrant stock issuable under the Company's Series A, B and J warrants. This agreement amended the Series J Warrants so that such warrants are exercisable for shares of the Company's Series B Convertible Preferred Stock, par value \$0.0001 per share (the "Series B Preferred Stock"). Prior to this agreement, such warrants were exercisable for shares of the Company's common stock.

In connection with this agreement, the Company designated 9,358,370 shares of preferred stock as "Series B Convertible Preferred Stock, par value \$0.0001 per share" with those rights and preferences as set forth in the Certificate of Designation of the Relative Rights and Preferences of the Series B Preferred Stock of the Company. The Series B Preferred Stock ranks senior to the Company's common stock and junior to the Company's Series A Preferred Stock. The shares of Series B Preferred Stock are convertible on a one-for-one basis into shares of the Company's common stock. Except with respect to specified transactions that may affect the rights, preferences, privileges or voting power of the Series B Preferred Stock and except as otherwise required by Nevada law, the Series B Preferred Stock has no voting rights. The Series B Preferred Stock is non-redeemable and is not entitled to dividends. When accounting for the Series B Preferred Stock, the Company determined that they qualified as equity because the aforementioned characteristics made them akin to common stock.

Investors holding the amended Series J Warrants exercised their right to purchase Series B Preferred Stock at \$2.33 per share. In 2008, certain investors exercised their amended Series J Warrants for a total of 6,369,078 shares of Series B Preferred Stock. The Company received gross proceeds of \$14,839,952 for the issuance of those shares in connection with the exercise of the Series J Warrants. The total amount of commission paid to the placement agent, 1st BridgeHouse Securities, was 10% of the gross proceeds, or \$1,483,995. The Company also paid a total of \$274,480 for other financing related expenses. The net proceeds from the transactions, after accounting for placement agent commissions and other related financing expenses, was \$13,081,477.

Simultaneously with the exercise of a portion of the Series J Warrants, a corresponding portion of the Series B and Series JJ Warrants became exercisable. Accordingly, the Company accounted for the net proceeds of this issuance by allocating to Par Value, Additional Paid in Capital attributable to Series B Preferred Stock, and Additional Paid in Capital attributable to Series B and JJ Warrants. The Company determined that the Series B Preferred Stock had a beneficial conversion feature (BCF). Accordingly, the Company accounted for this BCF as a constructive preferred dividend, which is a charge that reduces retained earnings and increases additional paid in capital attributable to the Series B Preferred Stock. The Company also transferred a prorated portion of proceeds previously recorded under Warrants A, J, B, and C to the Additional Paid in Capital of Series B Preferred Stock to reflect the exercise of the amended Series J Warrants.

In accordance to EITF 00-27 and EITF 98-5, the Company accounted for the modification of the Series J warrants as capital transaction because the modification of the warrants was concurrent with the Company's investors contributing more working capital to the Company through the exercise of the Series J warrants. In consideration of SFAS 123(R), the Company does not believe there is additional incremental value that should be charged to earnings because the fair value assigned to the Series B Convertible Preferred Stock was less than the fair value of the Company's common stock based on the market's closing price on September 5, 2008 and the valuation provided by investment bankers on September 3, 2008. The Series J warrant holders did not receive any additional value as a result of the amendment.

Warrant Recapitalization

On December 13, 2010, the Company entered into a series of agreements designed to reduce the overhang of the Company's Series A, B, C, AA, BB and JJ warrants and to simplify the Company's capital structure.

With respect to the Series A and Series B warrants, each Series A and Series B warrant holder was given the option to (i) sell all or part of such holder's warrant to Fame Good International Limited, the Company's controlling stockholder ("Fame Good"), for \$0.50 per share of warrant stock pursuant to a Warrant Purchase Agreement entered into by and among the Company, Fame Good and certain warrant holders (the "Warrant Purchase Agreement") and/or (ii) exchange all or part of such holder's warrant for the issuance by the Company of 0.5 shares of the Company's common stock, par value \$0.0001 per share, per share of warrant stock pursuant to a Warrant Exchange Agreement entered into by and among the Company and certain warrant holders (the "Series A and B Warrant Exchange Agreement"). The director and controlling stockholder of Fame Good is Mr. Xu Jie, who currently serves as the Chairman of the Company.

The Series A and Series B warrant holders sold warrants to purchase an aggregate of 3,913,905 shares of common stock to Fame Good under the Warrant Purchase Agreement and exchanged warrants to purchase an aggregate of 9,865,222 shares of common stock with the Company under the Series A and B Warrant Exchange Agreement. The warrant purchase closed on December 13, 2010, and the warrant exchange with the Series A and Series B warrant holders, other than Fame Good, closed on the same date. In total, the Company issued 4,932,609 shares of common stock in connection with the recapitalization of the Series A and Series B warrants. This amount includes 1,956,952 shares of common stock issued to Fame Good upon the exchange of the warrants that it purchased from certain Series A and B warrant holders. The Company closed on the warrant exchange with Fame Good on January 21, 2011.

With respect to its Series C, AA, BB and JJ warrants, the Company entered into a Warrant Exchange Agreement with Fame Good and all of the Series C, AA, BB and JJ warrant holders (the "Series C, AA, BB and JJ Warrant Exchange Agreement") pursuant to which the Company exchanged all of the outstanding Series C, AA, BB and JJ warrants for the issuance by the Company of (i) 1.372921615 shares of the Company's common stock per share of Series C warrant stock; (ii) 0.8203 shares of the Company's common stock per share of Series AA and Series BB warrant stock; and (iii) 0.8288 shares of the Company's common stock per share of Series JJ warrant stock. The Company closed on the warrant exchange with the Series C, AA, BB and JJ warrant holders on January 21, 2011. The Company issued 2,220,456 shares of common stock to the Series C, AA, BB and JJ warrant holders at this closing.

Upon completion of the warrant recapitalization on January 21, 2011, the Company had 32,505,000 shares of common stock outstanding. After the completion of the transactions, the Company had one Series A warrant outstanding representing the right to purchase 128,755 shares of the Company's common stock. The Company no longer has any Series B, C, AA, BB or JJ warrants outstanding.

Establishment of Wuhan Sungreen

On December 25, 2008, Wuhan Blower entered into an Asset Purchase Agreement with Wuhan Gongchuang Real Estate Co., Ltd., pursuant to which Wuhan Blower acquired certain assets including certain buildings, equipment and land use rights (the “Sukong Assets”). In connection with this acquisition, we created Wuhan Sungreen to hold the Sukong Assets and develop these assets into a new business that produces and supplies blower parts and machinery equipment to Wuhan Blower, Wuhan Generating and third party customers. On December 29, 2010, we decided to sell the assets and business of Wuhan Sungreen. For more information, see “Part I, Item 1. Business – Recent Developments.”

Recent Developments

Effective December 29, 2010, we decided to sell the assets and business of Wuhan Sungreen. Accordingly, the results of Wuhan Sungreen’s operations have been excluded from continuing operations and reported as discontinued operations for the year ended December 31, 2010. Wuhan Sungreen is continuing its operations pending further action. As of December 31, 2010, we estimate that the fair market value of Wuhan Sungreen’s assets is approximately \$18 to 24 million. We anticipate that all of the Wuhan Sungreen assets will be sold prior to January 1, 2013, and that any proceeds from the sale of such assets will be used to meet the working capital needs of Wuhan Blower and Wuhan Generating and/or to purchase new equipment for Wuhan Blower and Wuhan Generating.

Our Products

We engage primarily in the design, development, manufacture and sale of industrial blowers in China. Our industrial blowers are used primarily in steam-driven electrical power generation plants. In addition, we produce steam and water turbines in our turbine manufacturing facilities and in the shared facilities. Steam and water turbines are manufactured principally for use in electrical and hydropower plants. Finally, we recently began producing blower parts and machinery equipment. This business supplies Wuhan Blower and Wuhan Generating with these parts and equipment and also sells them to third parties.

Industrial Blowers

Industrial Blowers Generally

Industrial blowers are used to move very large volumes of air through industrial processes. When used in conjunction with an industrial furnace in steam-driven electrical power generation plants, they:

- blow air into furnaces in order to increase oxygen and improve combustion;
- blow fuel (primarily coal dust) into furnaces; and
- remove furnace exhaust.

If pollution control is required for the waste gases, then:

- a blower will propel the exhaust gases through a pollution reduction unit (such as a de-sulphurization unit); and
- a final blower will push the “cleaned” gases to and through the smokestack.

Industrial blowers are custom-made for the specific installation in which they will be used. The blower can be driven by an industrial scale electric motor, a diesel engine or a steam turbine. In addition to their use in power generation plants, industrial blowers are also used in the metallurgy and petrochemicals industries, as well as for ventilation in mines, mass transit (subways, tunnels, stations) and sewage treatment (for aeration).

Our Industrial Blower Products

Our primary blower products are:

Axial fans. These consist of a bladed impeller (fan) in an elongated cylindrical casing and are primarily used to provide high-volume, low-pressure air for larger power stations of 200 to 1,000 megawatts.

Centrifugal Blowers. These consist of a “squirrel cage” type impeller (or rotor) in a scroll- or spiral-shaped casing. Air is drawn into the center of the squirrel cage through a hole in the side of the casing and is thrown out at a right angle by the rotational force. These blowers provide lower volumes of air, but at higher pressures, and are used in medium-sized power stations of 100 to 300 megawatts for blowing coal dust into furnaces. They are also used for aeration in sewage treatment plants.

When required for noise abatement purposes, we also manufacture silencers or “mufflers” fitted to the exhaust side of our centrifugal blowers. These silencers are very similar in form and function to the muffler on an automobile: the silencer interior is fitted with perforated metal trays that are padded with a sound absorbing material such as fiberglass.

We are one of the largest suppliers of industrial blowers in our market to the Chinese electrical power generation industry, which is growing rapidly. All of our products are custom-built for specific purchasers. The majority of our product revenue comes from competitive bidding.

A typical blower costs approximately \$90,000 and takes 60 to 100 days to build, from design to finish. We are currently producing approximately 500 blower/fan units per year.

The manufacture of these products combines both low-tech and high-tech processes. The low-tech process consists of the cutting and welding of the steel for both the rotors and the casings. The high-tech process consists of the product design, the “finish” manufacturing of the rotor shafts, and the balancing of the rotor assemblies.

We make extensive use of computer aided design (CAD) and computer aided engineering (CAE) in the design phase of our manufacturing process. In particular, CAE provides us with the ability to do finite element analysis of our rotor designs, while CAD allows us to do three dimensional modeling (to include molding coordinates for the fan/blower blades) and design of the inlet and outlet parameters. Our relationships with the Science and Technology University of Central China, Jiaotong University and the Acoustic Institute of the China Science Academy allow us to stay abreast of the latest developments in the fields of fluid dynamics, material sciences and acoustics.

We have a sophisticated acoustics lab in our facility. We share this acoustics lab with our university partners, and the China Fan Performance Test Center uses it for some of its work.

Through the use of the above technologies, we are able to design fans/blowers of the highest efficiency providing precisely the volumes and pressures required. Parts purchased from third parties consist mainly of the electric motor specified by the client (normally equal to about 20% of the build cost of the assembly) and bearing castings.

Turbines

Steam Turbines Generally

In a steam-driven electrical or thermal power generation plant, blowers like those we manufacture feed fuel and air into a large furnace. The primary purpose of the furnace is to produce steam for the powering of steam-driven turbines. A steam turbine takes the force of the steam and converts it into rotary motion, which is then used to drive machinery.

Steam turbines are normally categorized by their output in watts – kilowatts through megawatts. A small steam turbine of 750 kilowatts is capable of lighting 7,500 100-watt light bulbs. A large 500 megawatt turbine can light 5 million 100-watt light bulbs or supply the power for a medium-sized city.

Steam turbines are high-precision, high-tolerance pieces of machinery and in many respects are similar to a jet engine. Each is built-to-order according to the design specifications of the customer. In general, they are very large pieces of machinery with extremely heavy castings. The manufacture of steam turbines, like blowers, requires both low-tech and high-tech processes.

Water Turbines Generally

For those applications such as a hydropower plant where the customer is close to a source of water power and does not need steam for other applications in its plant, a water turbine may be more economical than a steam turbine. In this case, the cost of building a source of water pressure (typically a dam) and the viaduct to the water turbine must be weighed against the cost of building a steam plant. In general, water turbines have lower tolerances and are considered lower technology than steam turbines.

A water turbine operates very much like an enclosed water wheel – high velocity incoming water pushes against the turbine blades, forcing the turbine to rotate and provide power to the attached generator set.

As with a steam turbine, each is built-to-order according to the design specifications of the customer. The most important consideration in the design is the height of the water column above the turbine, which will determine how large the turbine must be and how fast it must turn to achieve the desired power output.

Our Turbine Products

We have been producing water turbines since 2007. We completed the construction of a new turbine manufacturing facility in 2009 for Wuhan Generating. We currently produce steam turbines at our new turbine manufacturing facility and we also produce steam turbines at our blower manufacturing facility and at a shared facility. As we receive additional turbine orders, we will purchase and install additional customized equipment in the facility to increase our production capacity.

We currently manufacture the following types of steam turbines:

Regular steam turbines - these turbines are designed to make maximum use of the steam, with any waste steam vented into the atmosphere through cooling towers.

Co-generation steam turbines - these turbines are designed to provide for the use of “waste steam” by a nearby industrial plant (such as a paper or chemical plant).

Steam turbine production is characterized by low unit volume with high unit revenue and margins. While it is difficult to generalize, a 100 megawatt steam turbine costs approximately \$6 million and takes three to six months to build.

Water turbines, on the other hand, bear a stronger resemblance (in manufacture) to our traditional industrial blowers. A water turbine resembles a blower operating in reverse, powered by water rather than air. Given this similarity, we began production of water turbines in our existing facilities and in shared facilities before our new turbine manufacturing facility was completed.

A typical ten megawatt water turbine costs approximately \$450,000 and takes three to four months to construct.

The design and manufacturing of steam and water turbines require a high degree of engineering skill. We maintain a close relationship with Beijing 3-D, a high tech enterprise co-sponsored by the Chinese Academy of Sciences, for the purpose of developing new designs and manufacturing technology for the power generation equipment manufacturing industry in China. Beijing 3-D has developed world-class 3-dimensional CAD tools for use in the design of steam and water turbines. We anticipate obtaining rights to this technology in exchange for payment of a sales royalty on turbines utilizing the technology, although no formal agreement is currently in place. We believe this technology gives us significant advantages in providing our customers with the highest quality turbines, tailored precisely to their needs. Through its use, we believe we are able to:

- increase steam generator thermal efficiency;
- reduce coal consumption; and
- increase megawatt output.

As a result, we believe that we compete effectively in the turbine market. We also help provide for China's need for cleaner and more efficient electric power production.

Development of Our Steam and Water Turbine Business

On January 9, 2007, Wuhan Blower completed the formation of Wuhan Generating. To develop the Company's turbine business, Wuhan Blower reached an understanding with China Chang Jiang Energy Corporation ("China Chang Jiang"), which owns Wuhan Turbine Works, a manufacturer of energy turbines for power plants. China Chang Jiang agreed to allow us to assume the operations of Wuhan Turbine Works related to the manufacture of steam turbines up to 300 megawatts and water turbines up to 200 megawatts. To this end, Wuhan Generating hired a number of the management team members from Wuhan Turbine Works. These former Wuhan Turbine Works management team members and a limited number of Wuhan Turbine Works skilled laborers helped Wuhan Generating launch its turbine

operations in 2007. Wuhan Generating recruited 180 employees in 2010, and upon the installation of all the customized equipment in our turbine manufacturing facility, Wuhan Generating expects to hire approximately 60 additional employees to assist with turbine manufacturing.

We utilized a management strategy for Wuhan Generating that is similar to the one we used for Wuhan Blower during its first two years: management and employee restructuring, movement to a new facility (on our existing premises) and an intense focus on research and development.

We have constructed a turbine manufacturing facility adjacent to our blower manufacturing facilities. We manufacture turbines at our turbine facility and at the shared facilities. We have purchased additional customized equipment for our turbine manufacturing facility and will install this equipment in order to increase our production capacity as we receive additional turbine orders from our customers. We have spent approximately \$29.9 million on the turbine plant and related equipment.

In addition, we have constructed an administrative building for the turbine manufacturing facility, which is located adjacent to the turbine manufacturing facility. The administrative building will be used by personnel in turbine supplies and sales and for other administrative tasks. Construction on the administrative building began in June 2006 and was completed in December 2007. We are currently conducting turbine sales from our blower administrative building. As our turbine sales and profitability grow, we will complete the interior of our turbine administrative building and transfer our current and future turbine administrative staff to this new building.

In July 2007, we entered into a contract for approximately \$26.37 million with Jiangsu Huangli Paper Industry Co., Ltd. (“Jiangsu Huangli”) to build a thermal electric power plant with four boiler furnaces and two turbine generator groups in Jiangyin, Jiangsu. The construction of the power plant was completed in 2010 and facility inspections and verifications are currently being undertaken. We expect that the facility inspections will be completed in the second quarter of 2012.

Our Market

The market for blowers, steam turbines and water turbines in China is directly driven by the growth in the country’s overall demand for electricity and the now mandated requirement for electrical generating equipment that is both more fuel efficient and less polluting. According to the Energy Information Administration, China currently has the second greatest amount of installed electrical capacity of any nation, trailing only the United States. China’s total installed electricity generating capacity in 2011 was approximately 4,600 gigawatts according to the China Bureau of Statistics. According to the People’s Daily Online, the Chinese government made the increase in installed capacity a major part of the 10th (2005) and 11th (2010) Five Year Plans. According to RNCOS, an industry research firm, China will consume around 16% of the world’s energy by 2020.

China’s electrical capacity is installed not only in centralized major power production plants, but also often on the premises of major industrial facilities. The on-site production of power allows a company to avoid brownouts or complete loss of service. In this manner, many companies have insulated themselves from the short-fall in overall capacity.

Distribution Methods

In our industrial blower and turbine businesses, we receive proposals and contracts mostly through referrals and competitive bidding. We have a marketing and sales team that provides support and consultation to our customers. We mainly market our products to steel companies, power plants, chemical companies, paper mills and hydroelectric power plants. We also collaborate with major system integrators to jointly develop and market new products. We have a well established sales team and a close involvement with major research institutes and design firms across China. We work jointly with these institutions to develop and customize products for the specific needs of our customers. We believe this interactive working relationship with customers has allowed us to win repeat business, increase visibility and enhance our growth.

We are still developing our relatively new blower and turbine parts and machinery equipment business. Currently, this business primarily manufactures products for use by our industrial blower and turbine businesses. Thus far, this business has utilized referrals and competitive bidding to secure orders from third parties. This business also has been working with our blower and turbine sales staff to market its products.

Our Customers

In our blower manufacturing business, we currently have a base of over 420 customers. Our turbine manufacturing business has approximately 65 customers. Our industrial parts and machinery equipment business has approximately 75 customers, not including Wuhan Blower and Wuhan Generating.

Raw Materials and Supplies

The principal raw materials used in the manufacture of our products are rolled steel and iron. We believe these materials are widely available from multiple sources, though we primarily obtain them from three suppliers: Wuhan Iron and Steel Group, Wuhan Pingwu Material Co. and Wuhan new DaLai materials Co., LTD

Research and Development

We believe that our research and development (“R&D”) facilities are among the most advanced in the industry. Our R&D department operates out of a facility at our Wuhan campus. Our relationships with the Science and Technology University of Central China, Jiaotong University and the Acoustic Institute of China Science Academy allow us to stay abreast of the latest developments in the fields of fluid dynamics, material sciences and acoustics. We have a sophisticated acoustics lab in our facility, which we share with our university partners and which the China Fan Performance Test Center uses for some of its work. During 2011, R&D expense was approximately 1% of sales and we expect R&D expense to be approximately 1.2% of 2012 sales in order to increase our marketing competitiveness. We try to offset these costs by decreasing production costs of our products.

Our Competition

We believe that there are currently approximately 2,200 blower and fan manufactures in China, but that most of these are small and do not have the R&D and manufacturing resources that we do. We compete mainly with six large scale manufacturers. We believe that there are currently approximately 300 turbine manufactures in China, but that most of these are small and do not have the R&D and manufacturing resources that we do. We believe there are approximately five significant manufacturers of steam and water turbines with whom we compete. In both our blower and turbine businesses, we compete primarily on the basis of reputation, price, quality, engineering, timeliness and post-purchase services.

Regulation

We do not face any significant government regulation of our businesses or in connection with the production of our products. We do not require any special government permits to produce our products other than those permits that are required of all corporations in China.

Our Employees

As of March 31, 2012, we employed approximately 810 full-time employees.

Each of Wuhan Blower, Wuhan Generating and Wuhan Sungreen has a trade union that protects employees' rights, aims to assist in the fulfillment of our economic objectives, encourages employee participation in management decisions and assists in mediating disputes between us and union members. This type of union is typical in the PRC and is not similar to American or European labor unions. We believe that we maintain a satisfactory working relationship with our employees and we have not experienced any significant labor disputes or any difficulty in recruiting employees for our operations.

As required by applicable Chinese law, we have entered into employment contracts with all of our officers, managers and employees.

Our employees in the PRC participate in a state pension scheme organized by Chinese municipal and provincial governments. In addition, as required by PRC law, we provide employees in the PRC with various types of social insurance, including medical insurance, unemployment insurance and occupational injury insurance.

Item 1A. Risk Factors.

An investment in our common stock or other securities involves a number of risks. You should carefully consider each of the risks described below before deciding to invest in our common stock or other securities. If any of the following risks develops into actual events, our business, financial condition or results of operations could be negatively affected, the market price of our common stock or other securities could decline and you may lose all or part of your investment.

The risk factors presented below are all of the ones that we currently consider material. However, they are not the only ones facing our Company. Additional risks not presently known to us, or which we currently consider immaterial, may also adversely affect us. There may be risks that a particular investor views differently from us, and our analysis might be wrong. If any of the risks that we face actually occur, our business, financial condition and operating results could be materially adversely affected and could differ materially from any possible results suggested by any forward-looking statements that we have made or might make. In such case, the trading price of our common stock or the value of our other securities could decline, and you could lose part or all of your investment.

Risk Factors Related to Our Business

Our substantial indebtedness could adversely affect our results of operations and financial condition and prevent us from fulfilling our financial obligations.

We have incurred substantial debt to finance our growth. As of December 31, 2011, we had approximately \$120.02 million of outstanding bank loans and notes. This indebtedness could have important consequences to us, such as:

- limiting our ability to obtain additional financing to fund growth, working capital, capital expenditures, debt service requirements or other cash requirements;
- limiting our operational flexibility due to the covenants contained in our debt agreements;
- limiting our ability to invest operating cash flow in our business due to debt service requirements;

limiting our ability to compete with companies that are not as highly leveraged and that may be better positioned to withstand economic downturns; and

increasing our vulnerability to fluctuations in market interest rates.

Our ability to meet our expenses and debt service obligations will depend on our future performance, which will be affected by financial, business, economic and other factors, including potential changes in customer preferences, the success of product and marketing innovation and pressure from competitors. If we do not have enough money to pay our debt service obligations, we may be required to raise additional equity capital, sell assets or borrow more money. We may not be able, at any given time, to raise additional equity capital, sell assets or borrow more money on terms acceptable to us or at all. In the past, we have refinanced our debt prior to maturity. However, there can be no assurance that we will be able to refinance our debt on favorable terms, if at all, in the future.

Default in payment by one or more customers that have large account receivable balances could adversely impact our results of operations and financial condition.

A significant portion of our working capital consists of accounts receivable from customers. As of December 31, 2011, we had an aggregate amount of \$56.57 million in accounts receivable. If customers responsible for a significant amount of accounts receivable were to become insolvent or otherwise unable or unwilling to make timely payments, our business, results of operation, financial condition or liquidity could be adversely affected. The recent economic downturn has resulted in longer payment cycles and increased collection costs in excess of management's expectations.

Our management has identified material weaknesses in our internal control over financial reporting and disclosure controls and procedures that, if not properly remediated, could result in material misstatements in our financial statements in future periods.

In conjunction with the preparation of this Form 10-K for the year ended December 31, 2011, our management carried out an evaluation of the effectiveness of the design and operation of our internal control over financial reporting and disclosure controls and procedures as of December 31, 2011. Based upon this evaluation, our CEO and CFO concluded that our internal control over financial reporting and disclosure controls and procedures contained significant deficiencies and material weaknesses and therefore were not effective. For more detailed information regarding our internal control over financial reporting and our disclosure controls and procedures, see Part II, Item 9A Controls and Procedures. If the remedial policies and procedures we implement are insufficient to address the identified material weaknesses, or if additional significant deficiencies or material weaknesses in our internal control over financial reporting or disclosure controls and procedures are discovered in the future, we may fail to meet our future reporting obligations, our financial statements may contain material misstatements and our operating results may be adversely affected. Any such failure also could adversely affect the results of the periodic management evaluations regarding the effectiveness of our internal control over financial reporting.

We have had, and continue to have, material weaknesses in internal control over financial reporting in prior fiscal years. Although we have taken certain actions in an effort to strengthen the weaknesses in our control structure, we cannot assure you that additional material weaknesses will not be identified in the future. If our internal control over financial reporting or disclosure controls and procedures are not effective, investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

We are consistently evaluating the design and operating effectiveness of our internal controls, a process which sometimes leads to modifications in such controls. As a result of such evaluations, we have instituted certain remedial measures designed to address certain material weaknesses in our internal control procedures. For more detailed information regarding our internal control over financial reporting and our disclosure controls and procedures, see Part II, Item 9A Controls and Procedures. These modifications could affect the overall effectiveness or evaluation of the control system in the future by us. If the remedial policies and procedures we implement are insufficient to address the identified material weaknesses, or if additional significant deficiencies or material weaknesses in our internal controls are discovered in the future, investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

We must implement additional and expensive procedures and controls in order to grow our business and organization and to satisfy reporting requirements, which will increase our costs and require additional management resources.

As a U.S. public reporting company, we are required to comply with the Sarbanes-Oxley Act and the related rules and regulations of the SEC, including the requirements that we maintain disclosure controls and procedures and adequate internal control over financial reporting. We also are required to comply with marketplace rules to maintain our NASDAQ listing. Compliance with the Sarbanes-Oxley Act and other SEC and NASDAQ requirements will increase our costs and require additional management resources. We have begun upgrading our procedures and controls and will need to continue to implement additional