Recon Technology, Ltd
Form 10-Q
February 13, 2014

U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2013

¨ 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 001-34409

**RECON TECHNOLOGY, LTD**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Cayman Islands** | **Not Applicable** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. employer identification number) |

**1902 Building C, King Long International Mansion**
**No. 9 Fulin Road**
**Beijing 100107 China**
(Address of principal executive offices and zip code)
**+86 (10) 8494-5799**
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

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

Indicate the number of shares outstanding of each of the issuer's classes of ordinary shares, as of the latest practicable date. The Company is authorized to issue 25,000,000 ordinary shares. As of the date of this report, the Company has issued and outstanding 4,528,311 shares.

**RECON TECHNOLOGY, LTD**
**FORM 10-Q**
**INDEX**

# Special Note Regarding Forward-Looking Statements

This document contains certain statements of a forward-looking nature. Such forward-looking statements, including but not limited to projected growth, trends and strategies, future operating and financial results, financial expectations and current business indicators are based upon current information and expectations and are subject to change based on factors beyond the control of the Company. Forward-looking statements typically are identified by the use of terms such as “look,” “may,” “should,” “might,” “believe,” “plan,” “expect,” “anticipate,” “estimate” and similar words, alth forward-looking statements are expressed differently. The accuracy of such statements may be impacted by a number of business risks and uncertainties that could cause actual results to differ materially from those projected or anticipated, including but not limited to the following:

- the timing of the development of future products;
- projections of revenue, earnings, capital structure and other financial items;
- statements of our plans and objectives;
- statements regarding the capabilities of our business operations;
- statements of expected future economic performance;
- statements regarding competition in our market; and
- assumptions underlying statements regarding us or our business.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to update this forward-looking information. Nonetheless, the Company reserves the right to make such updates from time to time by press release, periodic report or other method of public disclosure without the need for specific reference to this report. No such update shall be deemed to indicate that other statements not addressed by such update remain correct or create an obligation to provide any other updates.

# Part I Financial Information

## Item 1. Financial Statements.

See the unaudited condensed consolidated financial statements following the signature page of this report, which are incorporated herein by reference.

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

*The following discussion and analysis of our company's financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes included elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. Actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors.*

**Overview**

We are a company with limited liability incorporated in 2007 under the laws of the Cayman Islands. Headquartered in Beijing, we provide products and services to oil and gas companies and their affiliates through Nanjing Recon Technology Co., Ltd. ("Nanjing Recon") and Beijing BHD Petroleum Technology Co., Ltd. ("BHD" and together with Nanjing Recon, our "Domestic Companies"). As the company contractually controlling the Domestic Companies, we are the center of strategic management, financial control and human resources allocation.

Our business is mainly focused on the upstream sectors of the oil and gas industry. We derive our revenues from the sales and provision of (1) hardware products, (2) software products, and (3) services. Our products and services involve most of the key procedures of the extraction and production of oil and gas, and include automation systems, equipment, tools and on-site technical services.

Our VIEs provide the oil and gas industry with equipment, production technologies, automation and services.

- Nanjing Recon: Nanjing Recon is a high-tech company that specializes in automation services for oilfield companies. It mainly focuses on providing automation solutions to the oil exploration industry, including monitoring wells, automatic metering to the joint station production, process monitor, and a variety of oilfield equipment and control systems.

- BHD: BHD is a high-tech company that specializes in transportation equipment and stimulation productions and services. Possessing proprietary patents and substantial industry experience, BHD has built up stable and strong working relationships with the major oilfields in China.

***Recent events***

On November 25, 2013 (as amended on November 29, 2013), the Company entered into a securities purchase agreement with certain institutional investors for the sale of 546,500 ordinary shares in a registered direct offering at the price of $4.81 per ordinary share (amended to $4.30 per ordinary share on November 29, 2013). The net cash proceeds received from the stock offering, after deducting placement agency fees and other associated fees, were

¥12,132,882 (approximately $2.0 million). Please see details in Note 14 - Stockholders' equity.

***Products and Services***

We provide the following three types of integrated products and services for our customers.

*Equipment for Oil and Gas Production and Transportation*

High-Efficiency Heating Furnaces. Crude petroleum contains certain impurities that must be removed before it can be sold, including water and natural gas. To remove the impurities and to prevent solidification and blockage in transport pipes, companies employ heating furnaces. BHD researched, developed and implemented a new oilfield furnace that is advanced, highly automated, reliable, easily operable, safe and highly heat-efficient (90% efficiency).

Burner. We serve as an agent for the Unigas Burner, which is designed and manufactured by UNIGAS, a European burning equipment production company. The burner we provide has the following characteristics: high degree of automation, energy conservation, high turn-down ratio, high security and environmental safety.

*Oil and Gas Production Improvement Techniques*

Packers of Fracturing. This utility model is used in concert with the security joint, hydraulic anchor, and slide brushing of sand spray in the well. It is used for easy seat sealing and sand uptake prevention. The utility model reduces desilting volume and prevents sand-up, which makes the deblocking processes easier to realize. The back flushing is sand-stick proof.

Production Packer. At varying withdrawal points, the production packer separates different oil layers and protects the oil pipe from sand and permeation, promoting the recovery ratio.

Sand Prevention in Oil and Water Well. This technique processes additives that are resistant to elevated temperatures into “resin sand” which is transported to the bottom of the well via carrying fluid. The “resin sand” goes through the borehole, pilling up and compacting at the borehole and oil vacancy layer. An artificial borehole wall is then formed, functioning as a means of sand prevention. This sand prevention technique has been adapted to more than 100 wells, including heavy oil wells, light oil wells, water wells and gas wells, with a 100% success rate and a 98% effective rate.

Water Locating and Plugging Technique. High water cut affects the normal production of oilfields. Previously, there was no sophisticated method for water locating and tubular column plugging in China. The mechanical water locating and tubular column plugging technique we have developed resolves the problem of high water cut wells. This technique conducts a self-sealing test during multi-stage usage and is reliable to separate different production sets effectively. The water location switch forms a complete set by which the water locating and plugging can be finished in one trip. The tubular column is adaptable to several oil drilling methods and is available for water locating and plugging in second and third class layers.

Fissure Shaper. This is our proprietary product that is used along with a perforating gun to effectively increase perforation depth by between 46% and 80%, shape stratum fissures, improve stratum diversion capability and, as a result, improve our ability to locate oilfields and increase the output of oil wells.

Fracture Acidizing. We inject acid to layers under pressure, which can form or expand fissures. The treatment process of the acid is defined as fracture acidizing. The technique is mainly adapted to oil and gas wells that are blocked up relatively deeply, or the ones in low permeability zones.

Electronic Break-Down Service. This service resolves block-up and freezing problems by generating heat from the electric resistivity of the drive pipe and utilizing a loop tank composed of an oil pipe and a drive pipe. This technique saves energy and is environmentally friendly. It can increase the production of oilfields that are in the middle and later periods.

*Automation System and Services*

Pumping Unit Controller. This controller functions as a monitor to the pumping unit and also collects data for load, pressure, voltage, and startup and shutdown control.

RTU Monitor. This monitor collects gas well pressure data.

Wireless Dynamometer and Wireless Pressure Gauge. These products replace wired technology with cordless displacement sensor technology. They are easy to install and significantly reduce the work load associated with cable laying.

Electric Multi-way Valve for Oilfield Metering Station Flow Control. This multi-way valve is used before the test separator to replace the existing three valve manifolds. It facilitates the electronic control of the connection of the oil lead pipeline with the separator.

Natural Gas Flow Computer System. The flow computer system is used in natural gas stations and gas distribution stations to measure flow.

Recon Supervisory Control and Data Acquisition System ("SCADA"). Recon SCADA is a system which applies to the oil well, measurement station, and the union station for supervision and data collection.

EPC Service of Pipeline SCADA System. This service technique is used for pipeline monitoring and data acquisition after crude oil transmission.

EPC Service of Oil and Gas Wells SCADA System. This service technique is used for monitoring and data acquisition of oil wells and natural gas wells.

EPC Service of Oilfield Video Surveillance and Control System. This video surveillance technique is used for controlling the oil and gas wellhead area and the measurement station area.

Technique Service for "Digital oilfield" Transformation. This service includes engineering technique services such as oil and gas SCADA system, video surveillance and control system and communication systems.

***Factors Affecting Our Business***

*Business Outlook*

The oilfield engineering and technical service industry is generally divided into five sections: (1) exploration, (2) drilling and completion, (3) testing and logging, (4) production, and (5) oilfield construction. Thus far our businesses have been involved in completion, production and construction processes. Our management still believe we need to expand our core business, move into new markets, and develop new businesses quickly for the coming yeaers. Management anticipates great opportunities both in new markets and our existing markets. We believe that many existing wells and oilfields need to improve or renew their equipment and service to maintain production and techniques and services like ours will be needed as new oil and gas fields are developed. In the next three years, we will focus on:

***Measuring Equipment and Service.*** "Digital oil field" and the management of oil companies are highly regarded. We believe our oilfield SCADA and related technical support services will address the needs of the oil well automation system market, for which we forecast strong needs in the short term. For the coming year, we will also expand our automation business market in China's biggest oilfield, the Da Qing oilfield. In addition, through early cooperation with CNPC in Turkmenistan, we have developed our experience in this market. Although bidding has not yet commenced, we will continue pursuing overseas business projects in the coming second phase construction, which we expect to occur in 2014.

***Gathering and Transferring Equipment.*** With more new wells developed, our management anticipates that demand for our furnaces and burners will grow more compared to last year, especially in the Jilin Oilfield and Zhongyuan oilfield.

***Fracturing service.*** We believe we cooperated well with Zhongyuan Oilfield in fiscal year 2013 and expect to continue growing revenue from fracturing and related stimulation services for fiscal year 2014, from Zhongyuan oilfield and also some other oilfields clients.

***New product line.*** Design and development of down-hole tools has always been an important technique for oilfield companies. Recently, this market has developed very rapidly. After a year test project for our customers, we have developed experience with this technology and our customers have accepted our products and services. We expect revenue from this business in fiscal year 2014.

*Growth Strategy*

As a smaller domestic company, it is our basic strategy to focus on developing our onshore oilfield business, that is, the upstream of the industry. Due to the remote location and difficult environments of China's oil and gas fields, foreign competitors rarely enter those areas.

Large domestic oil companies have historically focused on their exploration and development businesses to earn higher margins and keep their competitive advantage. With regard to private oilfield service companies, we estimate that approximately 90% specialize in the manufacture of drilling and production equipment. Thus, the market for technical support and project service is still in its early stage. Our management believes that insists on providing high quality products and service in the oilfield where we have a geographical advantage. This will allow us to avoid conflicts of interest with bigger suppliers of drilling equipment and protect our position within the market segment. Our mission is to increase the automation and safety levels of industrial petroleum production in China and improve the underdeveloped working process and management mode by using advanced technologies. At the same time, we are always looking to improve our business and to increase our earning capability.

*Industry and Recent Developments*

Despite uncertainty in the energy industry related to such matters as fluctuating prices and future opportunities for oil companies, our management believes there are still many factors to support our long-term development:

The opening of the Chinese oil industry to participation by non-state owned service providers and vendors played an increasingly important role in the high-end oilfield service segment to allow competition based on efficiency and price. As oil and gas fields are depleted, it becomes more challenging to find and convert reserves into usable energy sources. As the industry has permitted competition by private companies and oil companies have formed separate service companies, high-tech service has gradually opened up to private companies.

Overseas assets of Chinese oilfield companies increased gradually, and they will provide more opportunity for domestic service companies to participate in foreign projects.

Management is focused on these factors and will seek to extend our business on the industrial chain, like providing more integrated services and incremental measures and growing our business from a predominantly up-ground business to include some down-hole services as well.

***Factors Affecting Our Results of Operations***

Our operating results in any period are subject to general conditions typically affecting the Chinese oilfield service industry including:

- the amount of spending by our customers, primarily those in the oil and gas industry;

growing demand from large corporations for improved management and software designed to achieve such corporate performance;

6

- the procurement processes of our customers, especially those in the oil and gas industry;
- competition and related pricing pressure from other oilfield service solution providers, especially those targeting the Chinese oil and gas industry;
- the ongoing development of the oilfield service market in China; and
- inflation and other macroeconomic factors.

Unfavorable changes in any of these general conditions could negatively affect the number and size of the projects we undertake, the number of products we sell, the amount of services we provide, the price of our products and services, and otherwise affect our results of operations.

Our operating results in any period are more directly affected by company-specific factors including:

- our revenue growth, in terms of the proportion of our business dedicated to large companies and our ability to successfully develop, introduce and market new solutions and services;
- our ability to increase our revenues from both old and new customers in the oil and gas industry in China;
- our ability to effectively manage our operating costs and expenses; and
- our ability to effectively implement any targeted acquisitions and/or strategic alliances so as to provide efficient access to markets and industries in the oil and gas industry in China.

## Critical Accounting Policies and Estimates

***Estimates and Assumptions***

We prepare our unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP), which require us to make judgments, estimates and assumptions. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that we believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. An accounting policy is considered critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time such estimate is made, and if different accounting estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements. We believe that the following policies involve a higher degree of judgment and complexity in their application and require us to make significant accounting estimates. The following descriptions of critical accounting policies, judgments and estimates should be read in conjunction with our consolidated financial statements and other disclosures included in this quarterly report. Significant accounting estimates reflected in our Company’s consolidated financial statements include revenue recognition, allowance for doubtful accounts, and useful lives of property and equipment.

***Consolidation of VIEs***

We recognize an entity as a VIE if it either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. We consolidate a VIE as its primary beneficiary when we have both the power to direct the activities that most significantly impact the entity’s economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. We perform ongoing assessments to determine whether an entity should be considered a VIE and whether an entity previous identified as a VIE continues to be a VIE and whether we continue to be the primary beneficiary.

Assets recognized as a result of consolidating VIEs do not represent additional assets that could be used to satisfy claims against our general assets. Conversely, liabilities recognized as a result of consolidating these VIEs do not represent additional claims on our general assets; rather, they represent claims against the specific assets of the consolidated VIEs.

***Revenue Recognition***

We recognize revenue when the following four criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been provided, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the customers and the customers have signed a completion and acceptance report, risk of loss has transferred to the customers, customers acceptance provisions have lapsed, or the Company has objective evidence that the criteria specified in customers' acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

*Hardware*

Revenue from hardware sales is generally recognized when the product is shipped to the customer and when there are no unfulfilled company obligations that affect the customer's final acceptance of the arrangement.

*Services*

The Company provides services to improve software functions and system requirements on separated fixed-price contracts. Revenue is recognized when services are completed and acceptance is determined by a completion report signed by the customer.

Deferred income represents unearned amounts billed to customers related to sales contracts.

***Fair Values of Financial Instruments***

The US GAAP accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The three levels of inputs are defined as follows:

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

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

Level 3 inputs to the valuation methodology are unobservable.

The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, advances to suppliers, trade accounts payable, accrued liabilities, advances from customers and notes payable approximate fair value because of the immediate or short-term maturity of these financial instruments. Long-term receivables and borrowings approximate fair value because their interest rates charged approximate the market rates for financial instruments with similar terms. The fair value of the warrants liability was determined using the Black-Scholes Model, as Level 2 inputs (See Note 13). Any changes in the assumptions that are used in the Black-Scholes Model may increase or decrease the warrants liability from quarter to quarter. Any change in adjustment would be charged to operations.

***Receivables***

Trade receivables are carried at original invoiced amount less a provision for any potential uncollectible amounts. Provisions are applied to trade receivables where events or changes in circumstances indicate that the balance may not be collectible. The identification of doubtful accounts requires the use of judgment and estimates of management. Our management must make estimates of the collectability of our accounts receivable. Management specifically analyzes accounts receivable, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We believe based on the current economic condition and our history of collections on accounts and notes receivable, our allowance for doubtful accounts was adequate at December 31, 2013.

***Valuation of Long-Lived Assets***

We review the carrying values of our long-lived assets for impairment whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, we project undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, we reduce the carrying value of the long-lived asset by the estimated excess of the carrying value over the projected discounted cash flows. In the past, we have not had to make significant adjustments to the carrying values of our long-lived assets, and we do not anticipate a need to do so in the future. However, circumstances could cause us to have to reduce the value of our capitalized assets more rapidly than we have in the past if our revenues were to significantly decline. Estimated cash flows from the use of the long-lived assets are highly uncertain and therefore the estimation of the need to impair these assets is reasonably likely to change in the future. Should the economy or acceptance of our assets change in the future, it is likely that our estimate of the future cash flows from the use of these assets will change by a material amount. There were no impairments at June 30, 2013 and December 31, 2013.

***Share-Based Compensation***

The Company accounts for share-based compensation in accordance with ASC Topic 718, Share-Based Payment. Under the fair value recognition provisions of this topic, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense with graded vesting on a straight  line basis over the requisite service period for the entire award. The Company has elected to recognize compensation expenses mainly using the Black-Scholes valuation model estimated at the grant date based on the award’s fair value.

**Results of Operations**

***Three Months Ended December 31, 2013 Compared to Three Months Ended December 31, 2012***

*Revenues*

| | For the Three Months Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | Increase / (Decrease) | | Percentage Change | |
| Hardware -non-related parties | ¥ | 18,082,903 | ¥ | 40,691,269 | ¥ | 22,608,366 | 125.03 | % |
| Hardware - related parties | | 712,847 | | 558,312 | | (154,535) | (21.68) | % |
| Service | | 20,504,959 | | 397,589 | | (20,107,370) | (98.1) | % |
| Software - non-related parties | | 5,192,712 | | 3,550,780 | | (1,641,932) | (31.6) | % |
| Software - related parties | | 1,487,179 | | 1,068,376 | | (418,803) | (28.2) | % |
| Total revenues | ¥ | 45,980,600 | ¥ | 46,266,326 | ¥ | 285,726 | 0.6 | % |

<u>Revenues</u>. Our total revenues increased by 0.6%, or ¥ 285,726 ($46,761), from approximately ¥46.0 million for the three months ended December 31, 2012 to ¥46.3 million ($7.6 million) for the same period of 2013. The changes in our revenues for the three-month period were due to the following factors:

(1) Hardware business. During the three-month ended December 31, 2013, the increase in hardware revenue was mainly caused by higher sales of automation business from Jidong Oilfield and Southwest branch of Sinopec and sales of furnaces from Qinghai Oilfield, Huabei oilfield and Jiling Oilfield. Overall, our newly developed customers contributed most of our increasing business.

9

(2) Service business. Service revenue for three months ended December 31, 2013 consisted mainly of minor maintenance services, which were provided upon request by customers. The decrease was mainly because we completed some major fracturing contracts during the quarter ended December 31, 2012 while no such major services was completed this quarter. Our fracturing business is still proceeding, and we also obtained new contracts in this business. In addition, we successfully achieved access certification of additional oilfield branches, which means we can provide fracturing service to a broader solid customer base.

(3) Hardware related parties. Sales of hardware from related parties decreased because we used to develop business on Ji Dong oilfield through a local agent company, of which our Chief Executive Officer was the legal representative through December 2013. After we achieved business entrance certification in the name of Recon and could cooperate with oilfield customers directly two years ago, revenue from related-parties decreased, while the local agency might still purchase automation products from Recon, there would be always revenue from related parties and the revenue of both hardware and software from related parties might fluctuate from period to period.

(4) Software business. The software sales to non related parties decreased approximately ¥1.6 million ($0.3 million). We record revenue as software sales if (1) the customer signs a separate software contract with us, or (2) the customer accepts VAT invoices for software. The amount of our revenues categorized as software sales may fluctuate because certain software may be sold with hardware at times as a whole product and not separately priced.

(5) Software business related parties. During the quarter ended December 31, 2013, we recorded software revenue of ¥1.1 million ($0.2 million) to a related party. As mentioned above, we used to develop business on Ji Dong oilfield through a local agent. Since we achieved business entrance certification by ourselves, revenue through the related party decreased overall, so software revenue from this related party also decreased this period.

*Cost and Margin*

| | For the Three Months Ended December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | | | 2013 | | | Increase / (Decrease) | | | Percentage Change | |
| Total revenues | ¥ | 45,980,600 | | ¥ | 46,266,326 | | ¥ | 285,726 | | 0.6 | % |
| Cost of revenues | | 31,960,827 | | | 29,741,914 | | | (2,218,913) | | (6.9) | % |
| Gross profit | ¥ | 14,019,773 | | ¥ | 16,524,412 | | ¥ | 2,504,639 | | 17.9 | % |
| Margin % | | 30.5 | % | | 35.7 | % | | 5.2 | % | | |

<u>Cost of revenues</u>. Our cost of revenues includes raw materials and costs related to design, implementation, delivery and maintenance of products and services. All materials and components we need can be purchased or manufactured by subcontracts. Usually the prices of electronic components do not fluctuate dramatically due to market competition and will not significantly affect our cost of revenues. However, specialized equipment and incentive chemical products may be directly influenced by metal and oil price fluctuations. Additionally, the prices of some imported accessories mandated by our customers can also impact our cost.

Our cost of revenues decreased from approximately ¥31.9 million in the three months ended December 31, 2012 to approximately ¥29.7 million ($4.9 million) for the same period of 2013, a decrease of approximately ¥2.2 million ($0.4 million), or 6.9%. As a percentage of revenues, our cost of revenues decreased from 69.5% in 2012 to 64.3% in 2013. This decrease was mainly caused by lower service costs because the Company didn't have any fracturing business for the three months ended December 31, 2013.

10

Gross profit. Our gross profit increased to approximately ¥16.5 million ($2.7 million) for the three months ended December 31, 2013 from approximately ¥14.0 million for the same period in 2012. Our gross profit as a percentage of revenue increased to 35.7% for the three months ended December 31, 2013 from 30.5% for the same period in 2012. This was mainly due to hardware revenue increased with higher gross profit margin during the three months ended December 31, 2013 compared to the same period last year.

In more detail:

| | For the Three Months Ended December 31, 2012 | For the Three Months Ended December 31, 2013 | Increase / (Decrease) | Percentage Change |
|---|---|---|---|---|
| Total revenues - hardware and software non-related parties | ¥ 23,275,615 | ¥ 44,242,049 | ¥ 20,966,434 | 90.1 % |
| Cost of revenues - hardware and software non-related parties | 14,739,526 | 29,480,982 | 14,741,456 | 100.0 % |
| Gross profit | ¥ 8,536,089 | ¥ 14,761,067 | ¥ 6,224,978 | 72.9 % |
| Margin % | 36.7 % | 33.4 % | (3.3) % | |

The revenue from hardware and software to non-related parties increased ¥20.9 million, mainly due to the increase from furnace sales and automation business in the three months ended December 31, 2013. The gross profit from the hardware and software sales to non-related parties increased ¥6.2 million ($1.0 million) compared to the same period of last year.

| | For the Three Months Ended December 31, 2012 | For the Three Months Ended December 31, 2013 | Increase / (Decrease) | Percentage Change |
|---|---|---|---|---|
| Total revenues - hardware and software - related parties | ¥ 2,200,026 | ¥ 1,626,688 | ¥ (573,338) | (26.1) % |
| Cost of revenues - hardware and software - related parties | 1,519,307 | 225,986 | (1,293,321) | (85.1) % |
| Gross profit | ¥ 680,719 | ¥ 1,400,702 | ¥ 719,983 | 105.8 % |
| Margin % | 30.9 % | 86.1 % | 55.2 % | |

11

Cost of revenue from hardware and software-related parties decreased as revenue decreased. While gross profit decreased was mainly because revenue decreased as we developed business directly with oilfield, rather than cooperation with some parties. As software business with higher margin accounted for a larger percentage this period, gross profit margin increased.

| | For the Three Months Ended December 31, | | Increase / | Percentage |
|---|---|---|---|---|
| | 2012 | 2013 | (Decrease) | Change |
| Total revenues - service | ¥ 20,504,959 | ¥ 397,589 | ¥ (20,107,370) | (98.1) % |
| Cost of revenues - service | 15,701,994 | 34,946 | (15,667,048) | (99.8) % |
| Gross profit | ¥ 4,802,965 | ¥ 362,643 | ¥ (4,440,332) | (92.4) % |
| Margin % | 23.4 % | 91.2 % | 67.8 % | |

¥20.5 million service revenue in the quarter ended December 31, 2012 was mainly due to several fracturing service contracts signed with Sinopec Zhongyuan oilfield. We generated 23.4% gross profit margin from these service contracts. There was no such project completed for this period, so no revenue from fracturing service was recorded. Our margin in 2013 was 91.2% because the revenues recognized in this quarter was largely due to final project acceptance by our client and corresponding project costs were largely recognized in prior periods.

*Operating Expenses*

| | For the Three Months Ended December 31, | | Increase / | Percentage |
|---|---|---|---|---|
| | 2012 | 2013 | (Decrease) | Change |
| Selling and distribution expenses | ¥ 1,634,196 | ¥ 2,250,518 | ¥ 616,322 | 37.7 % |
| % of revenue | 3.6 % | 4.9 % | 1.3 % | |
| General and administrative expenses | 2,502,646 | 3,715,640 | 1,212,994 | 48.5 % |
| % of revenue | 5.4 % | 8.0 % | 2.6 % | |
| Research and development expenses | 4,198,861 | 2,661,397 | (1,537,464) | (36.6) % |
| % of revenue | 9.1 % | 5.8 % | (3.3) % | |
| Operating expenses | ¥ 8,335,703 | ¥ 8,627,555 | ¥ 291,852 | 3.5 % |

Selling and distribution expenses. Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing organization, sales commissions, costs of our marketing programs including advertising and trade shows, and an allocation of our facilities and depreciation expenses. Selling expenses increased by 37.7%, from approximately ¥1.6 million for the three months ended December 31, 2012 to approximately ¥2.3 million ($0.4 million) for the same period of 2013. This increase was primarily from the increased shipping charges and service charges. Selling expenses were 3.6% of total revenues in the three months ended December 31, 2012 and 4.9% of total revenues in the same period of 2013.

General and administrative expenses. General and administrative expenses consist primarily of costs in human resources, facilities costs, depreciation expenses, professional advisor fees, audit fees, option expenses and other expenses incurred in connection with general operations. General and administrative expenses increased by 48.5%, or ¥1.2 million ($0.2 million), from approximately ¥2.5 million in the three months ended December 31, 2012 to approximately ¥3.7 million ($0.6 million) in the same period of 2013. General and administrative expenses were 5.4% of total revenues in 2012 and 8.0% of total revenues in 2013. The increase in general and administrative expenses was mainly due to an increase in fees related to IR service, salary, allowance for doubtful accounts and traveling expenses.

Research and development ("R&D") expenses. Research and development expenses consist primarily of salaries and related expenditures of our research and development projects. Research and development expenses decreased by 36.6%, from approximately ¥4.2 million for the three months ended December 31, 2012 to approximately ¥2.7 million ($0.4 million) for the same period of 2013. This decrease was primarily due to less input of materials and equipment of R&D on our furnaces.

12

*Net Income*

| | For the Three Months Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | Increase / (Decrease) | | Percentage Change | |
| Income from operations | ¥ | 5,684,070 | ¥ | 7,896,857 | ¥ | 2,212,787 | 38.9 | % |
| Interest and other income (expense) | | 626,805 | | (65,253) | | (692,058) | (110.4) | % |
| Income before income tax | | 6,310,875 | | 7,831,604 | | 1,520,729 | 24.1 | % |
| Provision for income tax | | 423,308 | | 1,251,862 | | 828,554 | 195.7 | % |
| Net Income | | 5,887,567 | | 6,579,742 | | 692,175 | 11.8 | % |
| Less: Net income attributable to non-controlling interest | | 599,206 | | 765,071 | | 165,865 | 27.7 | % |
| Net income attributable to ordinary shareholders | ¥ | 5,288,361 | ¥ | 5,814,671 | ¥ | 526,310 | 10.0 | % |

Income from operations. Income from operations was approximately ¥7.9 million ($1.3 million) for the three months ended December 31, 2013, compared to income of ¥5.7 million for the same period of 2012. This increase in income from operations can be attributed primarily to the increased revenue, gross margins and decreases in research and development expenses.

Interest and other income (expense). Interest and other expense was approximately ¥0.1 million ($10,679) for the three months ended December 31, 2013, compared to interest and other income of ¥0.6 million for the same period of 2012. The ¥0.7 million ($0.1 million) decrease in interest and other income was primarily due to increase in loss from investment and decrease in subsidy income, interest expense and foreign currency exchange loss.

Investment loss. The Company held approximately 25.0% interest of Avalon at December 31, 2013. Since Avalon's operating results for three months ended December 31, 2013 will not be available as of the filing date, the Company used Avalon's last quarter's operating results as the best estimate for the three months ended December 31, 2013, which was a loss of approximately ¥0.4 million ($0.06 million).

Provision for income tax. Provision for income tax for the three months ended December, 2012 was approximately ¥0.4 million and ¥1.3 million ($0.2 million) for the three months ended December 31, 2013. This increase of provision for income tax was mainly due to the income from operations for the three months ended December 31, 2013.

Net income. As a result of the factors described above, net income was approximately ¥6.6 million ($1.1 million) for the three months ended December 31, 2013, an increase of approximately ¥0.7 million ($0.1 million) from net income of ¥5.9 million for the same period of 2012.

Net income attributable to ordinary shareholders. As a result of the factors described above, net income attributable to ordinary shareholders was approximately ¥5.8 million ($0.9 million) for the three months ended December 31, 2013, an increase of approximately ¥0.5 million ($0.1 million) from net income attributable to ordinary shareholders of ¥5.3 million for same period of 2012.

13

***Six Months Ended December 31, 2013 Compared to Six Months Ended December 31, 2012***

*Revenues*

| | For the Six Months Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | Increase / (Decrease) | | Percentage Change | |
| Hardware - non-related parties | ¥ | 26,605,044 | ¥ | 49,865,284 | ¥ | 23,260,240 | 87.4 | % |
| Hardware - related parties | | 1,244,898 | | 674,785 | | (570,113) | (45.8) | % |
| Service | | 20,504,959 | | 397,589 | | (20,107,370) | (98.1) | % |
| Software - non-related parties | | 5,192,712 | | 5,473,857 | | 281,145 | 5.4 | % |
| Software - related parties | | 1,487,179 | | 1,367,521 | | (119,658) | (8.0) | % |
| Total revenues | ¥ | 55,034,792 | ¥ | 57,779,036 | ¥ | 2,744,244 | 5.0 | % |

Revenues. Our total revenues increased by 5.0%, or approximately ¥2.7 million ($0.4 million), from ¥55.0 million for the six months ended December 31, 2012 to ¥57.8 million ($9.5 million) for the same period of 2013. The changes in our revenues for the six-month period were due to the following factors:

(1) Hardware business. During the six-month ended December 31, 2013, the increase in hardware revenue was mainly due to higher sales of furnaces and automation products.

(2) Service business. Service revenue for six months ended December 31, 2013 consisted mainly of minor maintenance services, which were provided upon request by customers. Our fracturing business is still proceeding, and we also obtained new contracts of this business. In addition, we successfully achieved access certification of other oilfield branches, which means we can provide fracturing service with broad solid customer base. The ¥20.5 million service revenue in the six months ended December 31, 2012 was mainly due to several fracturing service contracts signed with Sinopec Zhongyuan oilfield.

(3) Hardware related parties. Sales of hardware from related parties decreased because we used to develop business on Ji Dong oilfield through some local agent companies. After we achieved business entrance certification in the name of Recon and could cooperate with oilfield customers directly two years ago, revenue from related-parties decreased, while the local agency might still purchase automation products from Recon, there would be always revenue from related parties and the revenue of both hardware and software from related parties might be fluctuated from year to year.

(4) Software business. The software sales increased approximately ¥0.3 million ($46,011). We record revenue as software sales if (1) the customer signs a separate software contract with us, or (2) the customer accepts VAT invoices for software. The amount of our revenues categorized as software sales may fluctuate because certain software may be sold with hardware at times as a whole product and not separately priced

(5) Software business related parties. In the six months ended December 31, 2013, we recorded software revenue of ¥1.4 million ($0.2 million) to a related party.

*Cost and Margin*

| | For the Six Months Ended December 31, | | | |
|---|---|---|---|---|
| | 2012 | 2013 | Increase / (Decrease) | Percentage Change |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total revenues | ¥ | 55,034,792 | ¥ | 57,779,036 | ¥ | 2,744,244 | 5.0 | % |
| Cost of revenues | | 38,569,594 | | 35,963,524 | | (2,606,070) | (6.8) | % |
| Gross profit | ¥ | 16,465,198 | ¥ | 21,815,512 | ¥ | 5,350,314 | 32.5 | % |
| Margin % | | 29.9% | | 37.8% | | 7.9% | | |

14

Cost of revenues. Our cost of revenues includes raw materials and costs related to design, implementation, delivery and maintenance of products and services. All materials and components we need can be purchased or manufactured by subcontracts. Usually the prices of electronic components do not fluctuate dramatically due to market competition and will not significantly affect our cost of revenues. However, specialized equipment and incentive chemical products may be directly influenced by metal and oil price fluctuations. Additionally, the prices of some imported accessories mandated by our customers can also impact our cost.

Our cost of revenues decreased from approximately ¥38.6 million in the six months ended December 31, 2012 to approximately ¥36.0 million ($5.9 million) for the same period of 2013, a decrease of approximately ¥2.6 million ($0.4 million), or 6.8%. As a percentage of revenues, our cost of revenues decreased from 70.1% in 2012 to 62.2% in 2013. This decrease was mainly caused by lower service costs.

Gross profit. Our gross profit increased to approximately ¥21.8 million ($3.6 million) for the six months ended December 31, 2013 from approximately ¥16.5 million for the same period in 2012. Our gross profit as a percentage of revenue increased to 37.8% for the six months ended December 31, 2013 from 29.9% for the same period in 2012. This was mainly due to fracturing service with lower margins, which accounted for a major part of our revenue during the six months ended December 31, 2012. As to our automation business and furnaces business, our margins were both improved because our products and services were well accepted by our clients, especially our newly developed clients.

In more detail:

| | For the Six Months Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | Increase / (Decrease) | | Percentage Change | |
| Total revenues - hardware and software non-related parties | ¥ 31,797,756 | | ¥ 55,339,141 | | ¥ 23,541,385 | | 74.0 | % |
| Cost of revenues - hardware and software non-related parties | 20,506,088 | | 35,599,656 | | 15,093,568 | | 73.6 | % |
| Gross profit | ¥ 11,291,668 | | ¥ 19,739,485 | | ¥ 8,447,817 | | 74.8 | % |
| Margin % | 35.5 | % | 35.7 | % | 0.2 | % | | |

Revenue from hardware and software to non related parties increased ¥23.5 million, mainly due to the hardware revenue increase from the furnaces sales and automation products in the six months ended December 31, 2013. The gross profit from the hardware and software sales to non-related parties increased ¥8.4 million ($1.4 million) compared to the same period of last year.

| | For the Six Months Ended December 31, | | | |
|---|---|---|---|---|
| | 2012 | 2013 | Increase / (Decrease) | Percentage Change |
| Total revenues - hardware and software - related parties | ¥ 2,732,077 | ¥ 2,042,306 | ¥ (689,771) | (25.2) % |
| Cost of revenues - hardware and software - related parties | 2,340,892 | 328,922 | (2,011,970) | (85.9) % |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Gross profit | ¥ | 391,185 | | ¥ | 1,713,384 | | ¥ | 1,322,199 | 338 | % |
| Margin % | | 14.3 | % | | 83.9 | % | | 69.6 | % | |

15

Cost of revenue from hardware and software-related parties decreased as corresponding revenue decreased. Gross margin increased, primarily because higher margin software business accounted for a larger percentage this period.

| | For the Six Months Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | | | 2013 | | | Increase / (Decrease) | Percentage Change | |
| Total revenues-service | ¥ | 20,504,959 | ¥ | 397,589 | ¥ | (20,107,370) | | (98.1) | % |
| Cost of revenues -service | | 15,722,614 | | 34,946 | | (15,687,668) | | (99.8) | % |
| Gross profit | ¥ | 4,782,345 | ¥ | 362,643 | ¥ | (4,419,702) | | (92.4) | % |
| Margin % | | 23.3 % | | 91.2 % | | 67.9 % | | | |

The ¥20.5 million service revenue for the six months ended December 31, 2012 was mainly due to several fracturing service contracts signed with Sinopec Zhongyuan oilfield. We generated 23.3% gross profit margin from these service contracts. Our margin in 2013 was 91.2% because the revenues recognized in this period was largely due to final project acceptance by our client and corresponding project costs were largely recognized in prior periods.

*Operating Expenses*

| | For the Six Months Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | Increase / (Decrease) | | Percentage Change | |
| Selling and distribution expenses | ¥ | 2,902,994 | ¥ | 3,604,440 | ¥ | 701,446 | 24.2 | % |
| % of revenue | | 5.3 % | | 6.2 % | | 0.9 % | | |
| General and administrative expenses | | 4,485,758 | | 6,457,563 | | 1,971,805 | 44.0 | % |
| % of revenue | | 8.2 % | | 11.2 % | | 3.0 % | | |
| Research and development expenses | | 5,732,189 | | 3,353,997 | | (2,378,192) | (41.5) | % |
| % of revenue | | 10.4 % | | 5.8 % | | (4.6) % | | |
| Operating expenses | ¥ | 13,120,941 | ¥ | 13,416,000 | ¥ | 295,059 | 2.2 | % |

Selling and distribution expenses. Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing organization, sales commissions, costs of our marketing programs including advertising and trade shows, and an allocation of our facilities and depreciation expenses. Selling expenses increased by 24.2%, from approximately ¥2.9 million for the six months ended December 31, 2012 to approximately ¥3.6 million ($0.6 million) for the same period of 2013. This increase was primarily from the increased shipping charge and service charge. Selling expenses were 5.3% of total revenues in the six months ended December 31, 2012 and 6.2% of total revenues in the same period of 2013.

General and administrative expenses. General and administrative expenses consist primarily of costs in human resources, facilities costs, depreciation expenses, professional advisor fees, audit fees, option expenses and other expenses incurred in connection with general operations. General and administrative expenses increased by 44.0%, or ¥2.0 million ($0.3 million), from approximately ¥4.5 million in the six months ended December 31, 2012 to approximately ¥6.5 million ($1.1 million) in the same period of 2013. General and administrative expenses were 8.2% of total revenues in 2012 and 11.2% of total revenues in 2013. The increase in general and administrative expenses was mainly due to increase in consulting fee related to IR services, salary, allowance for doubtful accounts and traveling expenses.

Research and development (“R&D”) expenses. Research and development expenses consist primarily of salaries and related expenditures of our research and development projects. Research and development expenses decreased by 41.5%, from approximately ¥5.7 million for the six months ended December 31, 2012 to approximately ¥3.4 million ($0.5 million) for the same period of 2013. This decrease was primarily due to the less input of materials and equipment of R&D on our furnaces and fracturing services in 2013.

16

*Net Income*

| | For the Six Months Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | Increase / (Decrease) | | Percentage Change | |
| Income from operations | ¥ | 3,344,257 | ¥ | 8,399,512 | ¥ | 5,055,255 | 151.2 | % |
| Interest and other income (expense) | | 659,958 | | (154,227) | | (814,185) | (123.4) | % |
| Income before income taxes | | 4,004,215 | | 8,245,285 | | 4,241,070 | 105.9 | % |
| Provision for income taxes | | 454,932 | | 1,459,189 | | 1,004,257 | 220.7 | % |
| Net income | | 3,549,283 | | 6,786,096 | | 3,236,813 | 91.2 | % |
| Less: Net income attributable to non-controlling interest | | 605,088 | | 924,981 | | 319,893 | 52.9 | % |
| Net income attributable to ordinary shareholders | ¥ | 2,944,195 | ¥ | 5,861,115 | ¥ | 2,916,920 | 99.1 | % |

Income from operations. Income from operations was approximately ¥8.4 million ($1.4 million) for the six months ended December 31, 2013, compared to income of ¥3.3 million for the same period of 2012. This increase in income from operations can be attributed primarily to increased revenue, gross margins and decreases in research and development expenses.

Investment loss. Investment loss was ¥0.7 million ($0.1 million) for the six months ended December 31, 2013. The Company held approximately 25.0% interest of Avalon at December 31, 2013. Since Avalon's operating results for three months ended December 31, 2013 will not be available as of the filing date, the Company used Avalon's last quarter's operating results as the best estimate for this period.

Interest and other income (expense). Interest and other expense was approximately ¥0.2 million ($25,240) for the six months ended December 31, 2013, compared to interest and other income of ¥0.7 million for the same period of 2012. The ¥0.8 million ($0.1 million) decrease in interest and other income was primarily due to increase in loss from investment and decrease in interest income and foreign currency exchange gain, increase in loss from investment and offset by increase in subsidy income and decrease in interest expense.

Provision for income tax. Provision for income tax for the six months ended December, 2012 was approximately ¥0.5 million and ¥1.5 million ($0.2 million) for the six months ended December 31, 2013. This increase of provision for income tax was mainly due to the income from operations for the six months ended December 31, 2013.

Net income. As a result of the factors described above, net income was approximately ¥6.8 million ($1.1 million) for the six months ended December 31, 2013, an increase of approximately ¥3.3 million ($0.5 million) from net income of ¥3.5 million for the same period of 2012.

Net income attributable to ordinary shareholders. As a result of the factors described above, net income attributable to ordinary shareholders was approximately ¥5.9 million ($1.0 million) for the six months ended December 31, 2013, an increase of approximately ¥2.9 million ($0.5 million) from net income attributable to ordinary shareholders of ¥2.9 million for same period of 2012.

17

*Adjusted EBITDA*

Adjusted EBITDA. We define adjusted EBITDA as net income (loss) adjusted for income tax expense, interest expense, loss from investment, non-cash stock compensation expense, depreciation and amortization. We think it is useful to an equity investor in evaluating our operating performance because: (1) it is widely used by investors in our industry to measure a company's operating performance without regard to items such as interest expense, depreciation and amortization, which can vary substantially from company to company depending upon accounting methods and book value of assets, capital structure and the method by which the assets were acquired; and (2) it helps investors more meaningfully evaluate and compare the results of our operations from period to period by removing the impact of our capital structure and asset base from our operating results.

| | For the Six Months Ended December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 RMB | | 2013 RMB | | 2013 USD | | Increase / (Decrease) | | Percentage Change | |
| Reconciliation of Adjusted EBITDA to Net Income (Loss) | | | | | | | | | | |
| Net income (loss) | ¥ | 3,549,283 | ¥ | 6,786,096 | $ | 1,110,581 | ¥ | 3,236,813 | 91.2 | % |
| Provision for income taxes | | 454,932 | | 1,459,189 | | 238,804 | | 1,004,257 | 220.7 | % |
| Interest expense and foreign currency adjustment | | 536,353 | | 599,040 | | 98,036 | | 62,687 | 11.7 | % |
| Change in fair value of warrants liability | | - | | 556 | | 91 | | 556 | 100 | % |
| Loss from investment | | - | | 735,080 | | 120,300 | | 735,080 | 100 | % |
| Stock compensation expense | | 907,153 | | 895,509 | | 146,555 | | (11,644) | (1.3) | % |
| Depreciation and amortization | | 315,157 | | 301,341 | | 49,316 | | (13,816) | (4.4) | % |
| Adjusted EBITDA | ¥ | 5,762,878 | ¥ | 10,776,811 | $ | 1,763,683 | ¥ | 5,013,933 | 87.0 | % |

Adjusted EBITDA improved by approximately ¥5.0 million ($0.8 million) to approximately ¥10.8 million ($1.8 million) for the six months ended December 31, 2013 compared to approximately ¥5.8 million income for the same period in 2012. This was due to improved operations.

## Liquidity and Capital Resources

Cash and Cash Equivalents. Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than six months. As of December 31 2013, we had cash and cash equivalents in the amount of approximately ¥21.7 million ($3.6 million).

Indebtedness. As of December 31, 2013, except for approximately ¥0.5 million ($0.1 million) of short-term borrowings from third parties, approximately ¥0.2 million ($33,000) of short-term borrowings from related parties, and ¥19.36 million ($3.2 million) in commercial loans from local banks, we did not have any finance leases or purchase commitments, guarantees or other material contingent liabilities.

Holding Company Structure. We are a holding company with no operations of our own. All of our operations are conducted through our Domestic Companies. As a result, our ability to pay dividends and to finance any debt that we may incur is dependent upon the receipt of dividends and other distributions from the Domestic Companies. In addition, Chinese legal restrictions permit payment of dividends to us by our Domestic Companies only out of its accumulated net profit, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, our Domestic Companies are required to set aside a portion (at least 10%) of their after-tax net income (after discharging all cumulated loss), if any, each year for compulsory statutory reserve until the amount of the reserve reaches 50% of our Domestic Companies' registered capital. These funds may be distributed to shareholders at the time of each Domestic Company's wind up.

Off-Balance Sheet Arrangements. We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. In addition, we have not entered into any derivative contracts that are indexed to our own shares and classified as shareholders' equity, or that are not reflected in our financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. Moreover, we do not have any variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

Capital Resources. To date we have financed our operations primarily through cash flows from operations, bank loans, short-term borrowings and stock offerings. As of December 31, 2013, we had total assets of approximately ¥172.8 million ($28.3 million), which includes cash of approximately ¥21.7 million ($3.6 million), net accounts receivable from third parties of approximately ¥66.7 million ($10.9 million), and net accounts receivable from related parties of approximately ¥17.8 million ($2.9 million). Working capital amounted to approximately ¥95.1million ($15.6 million), and shareholders' equity amounted to approximately ¥104.0 million ($17.0 million).

Cash from Operating Activities. Net cash used in operating activities was approximately ¥6.8 million ($1.1 million) for the six months ended December 31, 2013. This was a decrease of approximately ¥12.0 million ($2.0million) compared to net cash provided by operating activities of approximately ¥5.2 million for the six months ended December 31, 2012. In more detail:

Net cash used in operating activities totaled approximately ¥6.8 million for the six months ended December 31, 2013, are primarily attributable to net income adjusted to reconcile to net cash provided by operating activities of ¥2.7 million, which primarily included adjustment for a ¥0.3 million of depreciation, a ¥0.4 million of provision for doubtful accounts, a ¥0.9 million of share based compensation, a $0.4 million of restricted shares issued to consulting firm and a ¥0.7 million of loss from investment. Net cash used in changes in operating assets and liabilities resulted in a net cash use of ¥16.2 million, which mainly due to a ¥22.7 million change in accounts receivable, notes receivable and other receivable, a ¥8.8 million change in inventory, a ¥1.3 million change in other payable, a ¥1.6 million change in accrued payroll and employees' welfare, offset by a ¥10.4 million change in accounts payable and other payable, a ¥3.3 million change in taxes payable and a ¥1.2 million change in prepaid expense. Our net cash used in operating activities were primarily for purchase of inventories for projects in the upcoming quarters. In addition, accounts receivable increased due to our operating seasonality. Most of our projects were finished by end of calendar year, and we believe these receivables will be recovered based on contractual payment schedules.

Cash from Investing Activities. Net cash used in investing activities was ¥36,495 ($5,973) for the six months ended December 31, 2013, a decrease of ¥359,495 ($58,883) from ¥395,990 for the same period of 2012. The decrease was due to a decrease in the purchase of property and equipment.

Cash from Financing Activities. Net cash provided by financing activities amounted to approximately ¥16.1 million ($2.6 million) for the six months ended December 31, 2013, compared to cash flows used in financing activities of approximately ¥6.6 million for the six months ended December 31, 2012. During the six-month period ended December 31, 2013, we received net proceeds of ¥12.1 million ($2.0 million) from a sale of 546,500 ordinary shares and warrants to institutional investors in November 2013. In addition, we repaid approximately ¥5.3 million ($0.9 million) short term borrowings to related parties and received ¥9.36 million ($1.5 million) of net loan proceeds from a commercial bank, which was guaranteed by one of our shareholders.

Working Capital. Total working capital as of December 31, 2013 amounted to approximately ¥95.1 million ($15.6 million), compared to approximately ¥82 million as of June 30, 2013. Total current assets as of December 31, 2013 amounted to approximately ¥163.9 million ($26.8 million), an increase of approximately ¥35.2 million ($5.8 million) compared to approximately ¥128.7 million at June 30, 2013. The increase in total current assets at December 31, 2013 compared to June 30, 2013 was mainly due to increase of cash and cash equivalents, trade accounts receivable and inventory.

Current liabilities amounted to approximately ¥68.7 million ($11.2 million) at December 31, 2013, in comparison to approximately ¥46.7 million at June 30, 2013. This increase of liabilities was attributable mainly to increase in short-term bank loans, trade accounts payable, taxes payable and warrant liability.

# Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

19

## Item 4. Controls and Procedures.

**Disclosure Controls and Procedures**

As of December 31, 2013, the company carried out an evaluation, under the supervision of and with the participation of management, including our Company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of our Company's disclosure controls and procedures. Based on the foregoing, the chief executive officer and chief financial officer concluded that our Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were ineffective in timely alerting them to information required to be included in the Company's periodic Securities and Exchange Commission filings.

**Changes in Internal Control over Financial Reporting**

The Company, with the assistance of an independent internal controls consultant, has developed a specific plan to address our control deficiencies. As of December 31, 2013, the Company has completed the necessary documentation of our internal controls and implemented the following remedial initiatives:

· Improved the design and documentation related to multiple levels of review over financial statements included in our SEC filings;
· Expanded the design and assessment test work over the monitoring function of entity level controls;
· Enhanced documentation retention policies over test work related to continuous management assessments of internal control effectiveness;
· Expanded documentation practices and policies related to various key controls to provide support and audit trails for both internal management assessment as well as external auditor testing; and
· Enhanced internal control policy implementation by hiring experienced reporting consultant and strengthening training financial staffs of US GAAP.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) during the three months ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting, except as disclosed above.

# Part II Other Information

## Item 1. Legal Proceedings.

None.

## Item 1A. Risk Factors.

Not applicable.

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

(a) None

20

(b) On November 29, 2013, we completed an offering of 546,500 ordinary shares and warrants to purchase 163,950 ordinary shares. Net proceeds from the offering were approximately $2.0 million. As previously disclosed, we intend to use the net proceeds from the offering for working capital and other general corporate purposes. As of the date of this filing, our use of proceeds is as follows:

| | | |
|---|---|---|
| Offering Amount | $ 2.0 | million |
| Purchase of Inventory | $ 0.3 | million |
| Working Capital and General Corporate Purposes | $ 0.4 | million |
| Remaining Offering Proceeds | $ 1.3 | million |

(c) None

## Item 3. Defaults upon Senior Securities.

None.

## Item 4. Mine Safety Disclosures.

Not applicable.

## Item 5. Other Information.

None.

## Item 6. Exhibits.

The following exhibits are filed herewith:

| Exhibit Number | Document |
|---|---|
| 3.1 | Amended and Restated Articles of Association of the Registrant (1) |
| 3.2 | Amended and Restated Memorandum of Association of the Registrant (1) |
| 4.1 | Specimen Share Certificate (1) |
| 10.1 | Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Beijing BHD Petroleum Technology Co., Ltd. (1) |
| 10.2 | Translation of Power of Attorney for rights of Chen Guangqiang in Beijing BHD Petroleum Technology Co., Ltd. (1) |
| 10.3 | Translation of Power of Attorney for rights of Yin Shenping in Beijing BHD Petroleum Technology Co., Ltd. (1) |
| 10.4 | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Beijing BHD Petroleum Technology Co., Ltd. (1) |

| | |
|---|---|
| 10.5 | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Beijing BHD Petroleum Technology Co., Ltd. (1) |
| 10.6 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Beijing BHD Petroleum Technology Co., Ltd. (1) |

21

| | |
|---|---|
| 10.7 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Beijing BHD Petroleum Technology Co., Ltd. (1) |
| 10.8 | Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Nanjing Recon Technology Co., Ltd. (1) |
| 10.9 | Translation of Power of Attorney for rights of Chen Guangqiang in Nanjing Recon Technology Co., Ltd. (1) |
| 10.10 | Translation of Power of Attorney for rights of Yin Shenping in Nanjing Recon Technology Co., Ltd. (1) |
| 10.11 | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Nanjing Recon Technology Co., Ltd. (1) |
| 10.12 | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Nanjing Recon Technology Co., Ltd. (1) |
| 10.13 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Nanjing Recon Technology Co., Ltd. (1) |
| 10.14 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Nanjing Recon Technology Co., Ltd. (1) |
| 10.15 | Employment Agreement between Recon Technology (Jining) Co., Ltd. and Mr. Yin Shenping (1) |
| 10.16 | Employment Agreement between Recon Technology (Jining) Co., Ltd. and Mr. Chen Guangqiang (1) |
| 10.17 | Operating Agreement among Recon Technology (Jining) Co. Ltd., Nanjing Recon Technology Co., Ltd. and Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi (1) |
| 10.18 | Operating Agreement among Recon Technology (Jining) Co. Ltd., Beijing BHD and Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi (1) |
| 21.1 | Subsidiaries of the Registrant (2) |
| 99.1 | Stock Option Plan (1) |
| 99.2 | Code of Business Conduct and Ethics (1) |
| 99.3 | Recon Technology Reports Second Quarter 2014 Financial Results |
| 31.1 | Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (3) |
| 31.2 | Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (3) |
| 32.1 | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (3) |

| | |
|---|---|
| 32.1 | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. [3] |
| 101.INS | XBRL Instance Document [4] |
| 101.SCH | XBRL Taxonomy Extension Schema Document [4] |

22

| | |
|---|---|
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document [(4)] |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document [(4)] |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document [(4)] |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document [(4)] |

(1) Incorporated by reference to the Company's Registration Statement on Form S-1, Registration No. 333-152964.
(2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q/A, filed on January 31, 2012.
(3) Filed herewith.
(4) Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

23

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**RECON TECHNOLOGY, LTD**

| | | |
|---|---|---|
| February 13, 2014 | By: | /s/ Liu Jia<br>Liu Jia<br>Chief Financial Officer<br>(Principal Financial and Accounting Officer) |

24

## SIGNATURES

In accordance with the requirements of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**RECON TECHNOLOGY, LTD**

| | | |
|---|---|---|
| February 13, 2014 | By: | /s/ Yin Shen ping<br>Yin Shen ping<br>Chief Executive Officer |

25

**RECON TECHNOLOGY, LTD**

INDEX TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS | PAGE

**RECON TECHNOLOGY, LTD**
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

| | As of June 30, 2013 RMB | | As of December 31, 2013 RMB | | As of December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| ASSETS | | | | | | |
| Current assets | | | | | | |
| Cash and cash equivalents | ¥ | 12,350,392 | ¥ | 21,733,565 | $ | 3,556,815 |
| Notes receivable | | 2,578,855 | | - | | - |
| Trade accounts receivable, net | | 38,648,780 | | 66,732,266 | | 10,921,096 |
| Trade accounts receivable- related parties, net | | 18,744,364 | | 17,798,136 | | 2,912,761 |
| Inventories, net | | 13,271,070 | | 22,070,728 | | 3,611,994 |
| Other receivables, net | | 19,131,503 | | 14,191,630 | | 2,322,537 |
| Other receivables- related parties | | 742,528 | | 595,304 | | 97,425 |
| Purchase advances, net | | 18,412,507 | | 17,680,032 | | 2,893,433 |
| Purchase advances- related parties | | 394,034 | | 394,034 | | 64,486 |
| Tax recoverable | | 575,650 | | - | | - |
| Prepaid expenses | | 2,853,956 | | 1,630,388 | | 266,821 |
| Deferred tax asset | | 1,006,721 | | 1,038,932 | | 170,027 |
| Total current assets | | 128,710,360 | | 163,865,015 | | 26,817,395 |
| | | | | | | |
| Property and equipment, net | | 1,709,846 | | 1,445,001 | | 236,482 |
| Long-term investment | | 1,549,450 | | 816,310 | | 133,594 |
| Long-term other receivable | | 3,502,680 | | 6,627,046 | | 1,084,552 |
| Total Assets | ¥ | 135,472,336 | ¥ | 172,753,372 | $ | 28,272,023 |
| | | | | | | |
| LIABILITIES AND EQUITY | | | | | | |
| Current liabilities | | | | | | |
| Short-term bank loans | ¥ | 10,000,000 | ¥ | 19,360,000 | $ | 3,168,369 |
| Trade accounts payable | | 7,384,165 | | 23,101,652 | | 3,780,710 |
| Trade accounts payable- related parties | | 3,994,718 | | - | | - |
| Other payables | | 1,964,691 | | 1,408,449 | | 230,500 |
| Other payable- related parties | | 4,239,675 | | 3,516,222 | | 575,449 |
| Deferred revenue | | 3,381,382 | | 3,926,136 | | 642,533 |
| Advances from customers | | 470,700 | | 554,162 | | 90,692 |
| Accrued payroll and employees' welfare | | 1,992,783 | | 353,382 | | 57,833 |
| Accrued expenses | | 488,730 | | 758,000 | | 124,052 |
| Taxes payable | | 6,754,428 | | 10,047,404 | | 1,644,312 |
| Short-term borrowings- related parties | | 5,503,279 | | 200,000 | | 32,731 |
| Short-term borrowings- other | | 570,375 | | 460,000 | | 75,281 |
| Warrants liability | | - | | 5,044,722 | | 825,596 |
| Total current liabilities | | 46,744,926 | | 68,730,129 | | 11,248,058 |
| | | | | | | |
| Commitments and Contingency | | | | | | |
| | | | | | | |
| Equity | | | | | | |
| Common stock, ($ 0.0185 U.S. dollar par value, 25,000,000 shares authorized; 3,951,811 and | | 529,979 | | 595,335 | | 97,428 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 4,528,311shares issued and outstanding as of June 30, 2013 and December 31, 2013, respectively) | | | | | | |
| Additional paid-in capital | | 69,516,447 | | 77,883,568 | | 12,746,067 |
| Appropriated retained earnings | | 3,023,231 | | 4,655,550 | | 761,906 |
| Unappropriated retained earnings | | 8,749,963 | | 12,978,762 | | 2,124,045 |
| Accumulated other comprehensive loss | | (293,201) | | (231,698) | | (37,918) |
| Total controlling shareholders' equity | | 81,526,419 | | 95,881,517 | | 15,691,528 |
| Non-controlling interest | | 7,200,991 | | 8,141,726 | | 1,332,437 |
| Total equity | | 88,727,410 | | 104,023,243 | | 17,023,965 |
| Total Liabilities and Equity | ¥ | 135,472,336 | ¥ | 172,753,372 | $ | 28,272,023 |

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

F-2

**RECON TECHNOLOGY, LTD**
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

| | For the six months ended December 31, | | | For the three months ended December 31, | | |
|---|---|---|---|---|---|---|
| | 2012 RMB | 2013 RMB | 2013 USD | 2012 RMB | 2013 RMB | 2013 USD |
| Revenues | | | | | | |
| Hardware and software | ¥ 31,797,756 | ¥ 55,339,141 | $ 9,056,550 | ¥ 23,275,615 | ¥ 44,242,049 | $ 7,240,451 |
| Service | 20,504,959 | 397,589 | 65,068 | 20,504,959 | 397,589 | 65,068 |
| Hardware and software - related parties | 2,732,077 | 2,042,306 | 334,234 | 2,200,026 | 1,626,688 | 266,216 |
| Total revenues | 55,034,792 | 57,779,036 | 9,455,852 | 45,980,600 | 46,266,326 | 7,571,735 |
| Cost of revenues | | | | | | |
| Hardware and software | ¥ 20,506,088 | ¥ 35,599,656 | $ 5,826,076 | ¥ 14,739,526 | ¥ 29,480,982 | $ 4,824,722 |
| Service | 15,722,614 | 34,946 | 5,719 | 15,701,994 | 34,946 | 5,719 |
| Hardware and software - related parties | 2,340,892 | 328,922 | 53,830 | 1,519,307 | 225,986 | 36,984 |
| Total cost of revenues | 38,569,594 | 35,963,524 | 5,885,625 | 31,960,827 | 29,741,914 | 4,867,425 |
| Gross profit | 16,465,198 | 21,815,512 | 3,570,227 | 14,019,773 | 16,524,412 | 2,704,310 |
| Selling and distribution expenses | 2,902,994 | 3,604,440 | 589,886 | 1,634,196 | 2,250,518 | 368,309 |
| General and administrative expenses | 4,485,758 | 6,457,563 | 1,056,815 | 2,502,647 | 3,715,640 | 608,085 |
| Research and development expenses | 5,732,189 | 3,353,997 | 548,900 | 4,198,860 | 2,661,397 | 435,552 |
| Operating expenses | 13,120,941 | 13,416,000 | 2,195,601 | 8,335,703 | 8,627,555 | 1,411,946 |
| Income from operations | 3,344,257 | 8,399,512 | 1,374,626 | 5,684,070 | 7,896,857 | 1,292,364 |
| Other income (expenses) | | | | | | |
| Subsidy income | 800,000 | 1,018,313 | 166,652 | 800,000 | 684,601 | 112,039 |
| Interest income | 305,588 | 204,970 | 33,544 | 304,278 | 101,769 | 16,655 |
| Interest expense | (876,414) | (479,648) | (78,497) | (546,658) | (258,389) | (42,287) |
| Loss from investment | - | (735,080) | (120,300) | - | (360,466) | (58,992) |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in fair value of warrants liability | | - | | 556 | | 91 | | - | | 556 | | 91 |
| Gain (loss) from foreign currency exchange | | 340,061 | | (119,392) | | (19,539) | | 73,601 | | (213,692) | | (34,972) |
| Other income (expense) | | 90,723 | | (43,946) | | (7,192) | | (4,416) | | (19,632) | | (3,213) |
| | | | | | | | | | | | | |
| Income before income tax | | 4,004,215 | | 8,245,285 | | 1,349,385 | | 6,310,875 | | 7,831,604 | | 1,281,685 |
| Provision for income tax | | 454,932 | | 1,459,189 | | 238,804 | | 423,308 | | 1,251,862 | | 204,874 |
| Net Income | | 3,549,283 | | 6,786,096 | | 1,110,581 | | 5,887,567 | | 6,579,742 | | 1,076,811 |
| | | | | | | | | | | | | |
| Less: Net income attributable to non-controlling interest | | 605,088 | | 924,981 | | 151,378 | | 599,206 | | 765,071 | | 125,208 |
| Net Income attributable to Recon Technology, Ltd | ¥ | 2,944,195 | ¥ | 5,861,115 | $ | 959,203 | ¥ | 5,288,361 | ¥ | 5,814,671 | $ | 951,603 |
| | | | | | | | | | | | | |
| Comprehensive income | | | | | | | | | | | | |
| Net income | | 3,549,283 | | 6,786,096 | | 1,110,581 | | 5,887,567 | | 6,579,742 | | 1,076,811 |
| Foreign currency translation adjustment | | (16,172) | | 77,277 | | 12,647 | | (210) | | 82,881 | | 13,564 |
| Comprehensive income | | 3,533,111 | | 6,863,373 | | 1,123,228 | | 5,887,357 | | 6,662,623 | | 1,090,375 |
| | | | | | | | | | | | | |
| Less: Comprehensive income attributable to non-controlling interest | | 603,291 | | 932,709 | | 152,643 | | 595,635 | | 773,360 | | 126,565 |
| Comprehensive income attributable to Recon Technology, Ltd | ¥ | 2,929,820 | ¥ | 5,930,664 | $ | 970,585 | ¥ | 5,291,722 | ¥ | 5,889,263 | $ | 963,810 |
| | | | | | | | | | | | | |
| Earnings per common share - basic | ¥ | 0.75 | ¥ | 1.44 | $ | 0.24 | ¥ | 1.34 | ¥ | 1.40 | $ | 0.23 |
| Earnings per common share - diluted | ¥ | 0.75 | ¥ | 1.44 | $ | 0.24 | ¥ | 1.34 | ¥ | 1.38 | $ | 0.23 |
| Weighted - average shares -basic | | 3,951,811 | | 4,056,963 | | 4,056,963 | | 3,951,811 | | 4,162,115 | | 4,162,115 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Weighted - average shares -diluted | 3,951,811 | 4,056,963 | 4,056,963 | 3,951,811 | 4,224,560 | 4,224,560 |

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

F-3

**RECON TECHNOLOGY, LTD**
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | For the six months ended December 31, | | |
|---|---|---|---|
| | 2012 | 2013 | 2013 |
| | RMB | RMB | U.S. Dollars |
| Cash flows from operating activities: | | | |
| Net income | ¥ 3,549,283 | ¥ 6,786,096 | $ 1,110,581 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation | 315,157 | 301,341 | 49,316 |
| Gain from disposal of equipment | (68,339) | - | - |
| Provision/(recovery of) for doubtful accounts | (251,451) | 378,584 | 61,957 |
| Share based compensation | 907,153 | 895,509 | 146,555 |
| Loss from investment | - | 735,080 | 120,300 |
| Deferred tax provision/(benefit) | 6,024 | (32,211) | (5,272) |
| Change in fair value of warrants liability | - | (556) | (91) |
| Restricted shares issued to consulting firm | - | 407,972 | 66,767 |
| Changes in operating assets and liabilities: | | | |
| Trade accounts receivable | (20,620,729) | (27,881,579) | (4,562,971) |
| Trade accounts receivable-related parties | 4,145,640 | 610,501 | 99,912 |
| Notes receivable | - | 2,578,855 | 422,044 |
| Other receivable, net | (793,654) | 1,830,372 | 299,549 |
| Other receivables related parties, net | (517,022) | 147,224 | 24,094 |
| Purchase advance, net | (1,435,147) | 472,846 | 77,384 |
| Purchase advance-related party, net | 699,500 | - | - |
| Tax recoverable | 2,790,722 | 575,650 | 94,208 |
| Prepaid expense | 424,771 | 1,223,568 | 200,244 |
| Inventories | 11,056,578 | (8,799,658) | (1,440,112) |
| Trade accounts payable | (2,698,700) | 15,717,487 | 2,572,252 |
| Trade accounts payable-related parties | 3,421,001 | (3,994,718) | (653,757) |
| Other payables | (958,746) | (556,242) | (91,032) |
| Other payables-related parties | 4,898,274 | (723,453) | (118,397) |
| Deferred income | (258,569) | 544,754 | 89,152 |
| Advances from customers | 475,295 | 83,462 | 13,659 |
| Accrued payroll and employees' welfare | 272,755 | (1,639,401) | (268,297) |
| Accrued expenses | (203,646) | 269,270 | 44,067 |
| Taxes payable | 54,589 | 3,292,976 | 538,913 |
| Net cash provided by (used in) operating activities | 5,210,739 | (6,776,271) | (1,108,975) |
| | | | |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (490,144) | (36,495) | (5,973) |
| Proceeds from disposal of equipment | 94,154 | - | - |
| Net cash used in investing activities | (395,990) | (36,495) | (5,973) |
| | | | |
| Cash flows from financing activities: | | | |
| Proceeds from short-term bank loans | 5,000,000 | 15,400,000 | 2,520,293 |
| Repayments of short-term bank loans | (12,000,000) | (6,040,000) | (988,479) |
| Proceeds from borrowings-related parties | 1,610,000 | - | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| Repayment of short-term borrowings | | (949,183) | | (110,375) | | (18,063) |
| Repayment of short-term borrowings-related parties | | (242,434) | | (5,303,279) | | (867,910) |
| Proceeds from sale of common stock, net of issuance costs | | - | | 12,132,882 | | 1,985,612 |
| Capital contribution in VIE | | 20,000 | | - | | - |
| Net cash provided by (used in) financing activities | | (6,561,617) | | 16,079,228 | | 2,631,453 |
| | | | | | | |
| Effect of exchange rate fluctuation on cash and cash equivalents | | 282,730 | | 116,711 | | 19,102 |
| | | | | | | |
| Net increase (decrease) in cash and cash equivalents | | (1,464,138) | | 9,383,173 | | 1,535,607 |
| Cash and cash equivalents at beginning of period | | 3,533,283 | | 12,350,392 | | 2,021,208 |
| Cash and cash equivalents at end of period | ¥ | 2,069,145 | ¥ | 21,733,565 | $ | 3,556,815 |
| | | | | | | |
| Supplemental cash flow information | | | | | | |
| Cash paid during the period for interest | ¥ | 943,986 | ¥ | 689,828 | $ | 112,894 |
| Cash paid during the period for taxes | ¥ | - | ¥ | - | $ | - |

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

F-4

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. ORGANIZATION AND NATURE OF OPERATIONS

***Organization*** Recon Technology, Ltd (the "Company") was incorporated under the laws of the Cayman Islands on August 21, 2007 as a company with limited liability. The Company provides oilfield specialized equipment, automation systems, tools, chemicals and field services to petroleum companies in the People's Republic of China (the "PRC"). Its wholly owned subsidiary, Recon Technology Co., Limited ("Recon-HK") was incorporated on September 6, 2007 in Hong Kong. Other than the equity interest in Recon-HK, the Company does not own any assets or conduct any operations. On November 15, 2007, Recon-HK established one wholly owned subsidiary, Jining Recon Technology Ltd. ("Recon-JN") under the laws of the PRC. Other than the equity interest in Recon-JN, Recon-HK does not own any assets or conduct any operations.

The Company conducts its business through the following PRC legal entities that were consolidated as variable interest entities ("VIEs") and operate in the Chinese oilfield equipment & service industry:

1. Beijing BHD Petroleum Technology Co., Ltd. ("BHD"), and

2. Nanjing Recon Technology Co., Ltd. ("Nanjing Recon").

**Nature of Operations** The Company engaged in (1) providing equipment, tools and other hardware related to oilfield production and management, including simple installations in connection with some projects; (2) service to improve production and efficiency of exploited oil wells, and (3) developing and selling its own specialized industrial automation control and information solutions. The products and services provided by the Company include:

*High-Efficiency Heating Furnaces* - High-Efficiency Heating Furnaces are designed to remove the impurities and to prevent solidification blockage in transport pipes carrying crude petroleum. Crude petroleum contains certain impurities including water and natural gas, which must be removed before the petroleum can be sold.
*Multi-Purpose Fissure Shaper* - Multipurpose fissure shapers improve the extractors' ability to test for and extract petroleum which requires perforation into the earth before any petroleum extractor can test for the presence of oil.

*Horizontal Multistage Fracturing related Service* - The Company mainly uses Baker Hughes FracPoint system and provides related service to oilfield companies. The Baker Hughes FracPoint system provided a completion method using packers to isolate sections of the wellbore (stages) and frac sleeves to direct the frac treatment to the desired stage. The use of this type of completion eliminated the need for cementing the liner, coiled tubing operations, and wireline operations, while significantly reducing overall pumping time.

*Supervisory Control and Data Acquisition System ("SCADA")* - SCADA is an industrial computerized process control system for monitoring, managing and controlling petroleum extraction. SCADA integrates underground and aboveground activities of the petroleum extraction industry. This system can help to manage the oil extraction process in real-time to reduce the costs associated with extraction.

## NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

***Reclassification*** The Company made some reclassification of revenue from software - related parties for the three and six months ended December 31, 2012.

***Basis of Presentation -*** The accompanying unaudited condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The accompanying unaudited condensed consolidated financial statements include the accounts of the Company, its subsidiaries, and VIEs for which the Company is the primary beneficiary. All inter-company transactions and balances between the Company, its subsidiaries and VIEs are eliminated upon consolidation. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring entries, which are necessary for a fair presentation of the results for the interim periods presented. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Form 10-K for the fiscal year ended June 30, 2013. The results of operations for the interim periods presented may not be indicative of the operating results to be expected for the Company’s fiscal year ending June 30, 2014.

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

***Variable Interest Entities -*** A VIE is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. A VIE is consolidated by its primary beneficiary. The primary beneficiary has both the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. We perform ongoing assessments to determine whether an entity should be considered a VIE and whether an entity previous identified as a VIE continues to be a VIE and whether we continue to be the primary beneficiary.

Assets recognized as a result of consolidating VIEs do not represent additional assets that could be used to satisfy claims against the Company's general assets. Conversely, liabilities recognized as a result of consolidating these VIEs do not represent additional claims on the Company's general assets; rather, they represent claims against the specific assets of the consolidated VIEs.

***Currency Translation*** - The Company's functional currency is the Chinese Yuan ("RMB") and the accompanying consolidated financial statements have been expressed in Chinese Yuan. The statements as of and for the three months period ended December 31, 2013 have been translated into United States dollars ("U.S. dollars") solely for the convenience of the readers. The translation has been made at the rate of ¥6.1104 = US$1.00, the approximate exchange rate prevailing on December 31, 2013. These translated U.S. dollar amounts should not be construed as representing Chinese Yuan amounts or that the Chinese Yuan amounts have been or could be converted into U.S. dollars.

***Estimates and assumptions***- The preparation of the consolidated financial statements in conformity with U.S. GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are adjusted to reflect actual experience when necessary. Significant estimates include revenue recognition, allowance for doubtful accounts, the useful lives of property and equipment and the fair value of stock based payments. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates.

***Fair Values of Financial Instruments*** - The US GAAP accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The three levels of inputs are defined as follows:

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

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

Level 3 inputs to the valuation methodology are unobservable.

The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, purchase advances, trade accounts payable, accrued liabilities, advances from customers, short-term bank loan and short-term borrowings approximate fair value because of the immediate or short-term maturity of these financial instruments. Long-term borrowings approximate fair value because the interest rate charged approximates the market rate. Long-term other receivables approximate fair value because interest rate approximates the market rate. Long-term investment is carried at less than fair value, with fair value determined using level 1 inputs. (See Note 8.)

The fair value of the warrants liability was determined using the Black-Scholes Model, as Level 2 inputs (See Note 13).

***Cash and Cash Equivalents -*** Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated original maturities of no more than three months. Since a majority of the bank accounts are located in the PRC, those bank balances are uninsured.

F-6

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

***Trade Accounts and Other Receivables*** - Accounts receivable are carried at original invoiced amount less a provision for any potential uncollectible amounts. Accounts are considered past due when the related receivables are more than a year old. Provision is made against trade accounts and other receivables to the extent they are considered to be doubtful. Accounts are written off after extensive efforts at collection. Other receivables arise from transactions with non-trade customers.

***Purchase Advances*** - Purchase advances are the amounts prepaid to suppliers for purchases of inventory and are recognized as inventory when the final amount is paid to the suppliers and the inventory is delivered.

***Inventories*** - Inventories are stated at the lower of cost or market value, on a weighted average basis for BHD. Inventories are stated at the lower of cost or market value, on a first-in-first-out basis for Nanjing Recon and ENI. The methods of determining inventory costs are used consistently from year to year. Allowance for inventory obsolescence is provided when the market value of certain inventory items are lower than the cost.

***Tax Recoverable*** Tax recoverable represented amounts paid for value added tax ("VAT") on purchases in the PRC amounting to ¥575,650 at June 30, 2013 and none at December 31, 2013. The amount can be used to offset VAT payable on sales made by the Company.

***Property and Equipment*** - Property and equipment are stated at cost. Depreciation on motor vehicles and office equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from two to ten years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the assets.

***Long-term investment*** Long-term investment in equity over which the Company has the ability to exercise significant influence but not control, and that, in general, are 20-50 percent owned, are stated at cost plus equity in undistributed net income (loss) of the investee. These investments are evaluated for impairment, in which an impairment loss would be recorded whenever a decline in the value of an equity investment below its carrying amount is determined to be "other than temporary." In judging "other than temporary," the Company would consider the length of time and extent to which the fair value of the investment has been less than the carrying amount of the investment, the near-term and longer-term operating and financial prospects of the investee, and the Company's longer-term intent of retaining the investment in the investee.

***Long-Lived Assets*** - The Company applies the ASC Topic 360 "Property, plant and equipment." ASC Topic 360 requires that long-lived assets, such as property and equipment be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. Fair value is determined based on the estimated discounted future cash flows expected to be generated by the asset. There were no impairments at June 30, 2013 and December 31, 2013.

***Revenue Recognition*** - The Company recognizes revenue when the following four criteria are met: (1) persuasive evidence of an arrangement, (2) delivery has occurred or services have been provided, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the customers and the customers have signed a completion and acceptance report, risk of loss has transferred to the customers, customers acceptance provisions have lapsed, or the Company has objective evidence that the criteria specified in customers' acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

Hardware:
Revenue from hardware sales is generally recognized when the product is shipped to the customer and when there are no unfulfilled company obligations that affect the customer's final acceptance of the arrangement.

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Software:
The Company sells self-developed software. For software sales, the Company recognizes revenues in accordance with ASC Topic 985 - 605 “Software Revenue Recognition”. Revenue from software is recognized according to project contracts. Contract costs are accumulated during the periods of installation and testing or commissioning. Usually this is short term. Revenue is not recognized until completion of the contracts and receipt of acceptance statements.

Service:
The Company provides services to improve software function and system operation on separated fixed-price contracts. Revenue is recognized on the completed contract method when acceptance is determined by a completion report signed by the customer.

Deferred revenue represents unearned amounts billed to customers related to sales contracts.

***Subsidy Income*** - Grants are given 1) by the government to support local software companies’ operation and research and development and 2) by some local government to support development of selected middle and small-sized enterprises. Grants related to research and development projects are recognized as subsidy income in the unaudited condensed consolidated statements of operations when received. Grants in the form of value-added-tax refund for software products are recognized when received.

***Share-Based Compensation -*** The Company accounts for share-based compensation in accordance with ASC Topic 718, *Share-Based Payment*. Under the fair value recognition provisions of this topic, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense with graded vesting on a straight line basis over the requisite service period for the entire award. The Company has elected to recognize compensation expenses mainly using the Black-Scholes valuation model estimated at the grant date based on the award’s fair value.

***Income Taxes*** - Income taxes are provided based upon the liability method of accounting pursuant to ASC Topic 740, *Accounting for Income Taxes*. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes. Deferred taxes are provided on differences between the tax bases of assets and liabilities and their reported amounts in the financial statements, and tax carry forwards. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company has not been subject to any income taxes in the United States or the Cayman Islands.

Under ASC Topic 740, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position would be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. Income tax returns for the years prior to 2009 are no longer subject to examination by tax authorities.

***Earnings (loss) per Share (“EPS”)*** - Basic EPS is computed by dividing net income (loss) attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding. Diluted EPS are computed by dividing net income (loss) attributable to ordinary shareholders by the weighted-average number of ordinary shares and dilutive potential ordinary share equivalents outstanding.

Basic net income per share is computed by dividing net income available to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted income per share is computed by dividing net income by the weighted average number of shares of ordinary shares, ordinary shares equivalents and potentially dilutive securities outstanding during each period. Potentially dilutive ordinary shares consist of ordinary shares issuable upon the conversion of ordinary stock options, restricted shares and warrants (using the treasury stock method). However, the effect from options, restricted shares and warrants would have been anti-dilutive due to the fact that the weighted average exercise price per share of options, restricted shares and warrants is higher than the weighted average market price per ordinary share during the six months ended December 31, 2012 and 2013. For the three months ended December 31, 2013, there were 62,445 restricted shares included in the weighted average dilutive shares calculation.

F-8

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 3. TRADE ACCOUNTS RECEIVABLE, NET

Accounts receivable consisted of the following:

| Third Party | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Trade accounts receivable | ¥ | 42,993,298 | ¥ | 70,874,876 | $ | 11,599,057 |
| Allowance for doubtful accounts | | (4,344,518) | | (4,142,610) | | (677,961) |
| Total - third- party, net | ¥ | 38,648,780 | ¥ | 66,732,266 | $ | 10,921,096 |

| Related Party | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Beijing Yabei Nuoda Science and Technology Co. Ltd. | ¥ | 19,722,574 | ¥ | 19,112,072 | $ | 3,127,794 |
| Allowance for doubtful accounts | | (978,210) | | (1,313,936) | | (215,033) |
| Total - related-parties, net | ¥ | 18,744,364 | ¥ | 17,798,136 | $ | 2,912,761 |

One of the Founders, Mr. Yin Shenping, is the legal representative of Beijing Yabei Nuoda Science and Technology Co. Ltd ("Yabei Nuoda"). The founder does not have any equity interest in this company currently. The receivable from Yabei Nuoda was generated primarily from the sale of automation system and services based on written contracts.

## NOTE 4. OTHER RECEIVABLES, NET

Other receivables consisted of the following:

| Third Party<br>Current Portion | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Due from ENI (A) | ¥ | 6,799,669 | ¥ | 2,474,147 | $ | 404,908 |
| Loans to third parties (B) | | 8,440,639 | | 7,462,126 | | 1,221,217 |
| Business advance to staff (C) | | 2,977,176 | | 4,113,633 | | 673,218 |
| Deposits for projects | | 185,669 | | 276,314 | | 45,220 |
| Others | | 1,210,230 | | 332,424 | | 54,403 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Allowance for doubtful accounts | | (481,880) | | (467,014) | | (76,429) |
| Total | ¥ | 19,131,503 | ¥ | 14,191,630 | $ | 2,322,537 |

F-9

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

| Third Party | June 30, 2013 | | December 31, 2013 | | December 31, 2013 | |
|---|---|---|---|---|---|---|
| Non-Current Portion | RMB | | RMB | | U.S. Dollars | |
| Due from ENI (A) | ¥ | 3,502,680 | ¥ | 6,627,046 | $ | 1,084,552 |
| Total | ¥ | 3,502,680 | ¥ | 6,627,046 | $ | 1,084,552 |

(A) Due from ENI represents a working capital loan to the Company's former VIE. The loan balance had been an intercompany balance and was eliminated in the Company's consolidated financial statements before the deconsolidation of ENI. It was reclassified to other receivables after ENI ceased to be a VIE of the Company on December 16, 2010. In January 2012, ENI agreed to repay the loan on a payment schedule, and interest is accruing during the period at an annual rate of 4%. In accordance with the payment schedule, the principal plus accrued interest is required to be repaid over approximately three years on a quarterly basis beginning March 2012. The first four payments were RMB 1.2 million each. In March, June, September and December of 2012, the Company received an aggregate of RMB 4.8 million. Starting March 2013, installments for each quarter would be ¥1,777,653. The Company has received the payments timely in March and June of 2013. On September 30, 2013, ENI proposed to extend the payment period and resigned an agreement with the Company. According to the new agreement, the remaining balance of this loan would be repaid over four years with installments of ¥699,147 each quarter including interest. The payments required after 1 year are RMB 6,627,046 ($1,084,552).

(B) Loans to third parties are mainly used for short-term funding to support cooperative companies. These loans are due on demand bearing no interest.

(C) Business advance to staff represents advances for business travel and sundry expenses related to oilfield or on-site installation and inspection of products through customer approval and acceptance.

Other receivables - related parties represent loans to related parties for working capital advances to related entities. Such advances are due-on-demand and non-interest bearing.

Below is a summary of other receivables - related parties which consisted of the following:

| Related Party | June 30, 2013 | | December 31, 2013 | | December 31, 2013 | |
|---|---|---|---|---|---|---|
| Name of Related Party | RMB | | RMB | | U.S. Dollars | |
| Beijing Yabei Nuoda Science and Technology Co. Ltd. | ¥ | 500,000 | ¥ | 500,000 | $ | 81,828 |
| Other-travel advances (A) | | 242,528 | | 95,304 | | 15,597 |
| Total | ¥ | 742,528 | ¥ | 595,304 | $ | 97,425 |

(A) Other travel advances were paid to the Company's management.

**NOTE 5. PURCHASE ADVANCES**

The Company purchased products and services from a third-party and a related party during the normal course of business. Purchase advances consisted of the following:

| Third Party | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Prepayment for inventory purchase | ¥ | 19,237,449 | ¥ | 18,764,603 | $ | 3,070,929 |
| Allowance for doubtful accounts | | (824,942) | | (1,084,571) | | (177,496) |
| Total | ¥ | 18,412,507 | ¥ | 17,680,032 | $ | 2,893,433 |

F-10

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Below is a summary of purchase advances to related party.

| Related Party | June 30, 2013 RMB | December 31, 2013 RMB | December 31, 2013 U.S. Dollars |
|---|---|---|---|
| Xiamen Huangsheng Hitek Computer Network Co. Ltd. | ¥ 394,034 | ¥ 394,034 | $ 64,486 |
| Total | ¥ 394,034 | ¥ 394,034 | $ 64,486 |

One of the Founders and a family member collectively own 57% of Xiamen Huasheng Haitian Computer Network Co. Ltd.

**NOTE 6. INVENTORIES**

Inventories consisted of the following:

| | June 30, 2013 RMB | December 31, 2013 RMB | December 31, 2013 U.S. Dollars |
|---|---|---|---|
| Small component parts | ¥ 45,314 | ¥ 52,922 | $ 8,661 |
| Work in process | 1,356,755 | 1,820,448 | 297,926 |
| Finished goods | 11,869,001 | 20,197,358 | 3,305,407 |
| Total inventories | ¥ 13,271,070 | ¥ 22,070,728 | $ 3,611,994 |

There was no inventory obsolescence reserve at June 30, 2013 and December 31, 2013.

**NOTE 7. PROPERTY AND EQUIPMENT, NET**

Property and equipment consisted of the following:

| | June 30, 2013 RMB | December 31, 2013 RMB | December 31, 2013 U.S. Dollars |
|---|---|---|---|
| Motor vehicles | ¥ 2,683,250 | ¥ 2,683,250 | $ 439,128 |
| Office equipment and fixtures | 593,654 | 630,150 | 103,127 |
| Total property and equipment | 3,276,904 | 3,313,400 | 542,255 |
| Less: Accumulated depreciation | (1,567,058) | (1,868,399) | (305,773) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Property and equipment, net | ¥ | 1,709,846 | ¥ | 1,445,001 | $ | 236,482 |

Depreciation expense was ¥242,778 and ¥150,973 ($24,708) for the three months ended December 31, 2012 and 2013, respectively.

Depreciation expense was ¥315,157 and ¥301,341 ($49,316) for the six months ended December 31, 2012 and 2013, respectively.

F-11

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 8. Long-term investment**

On June 28, 2013, the Company purchased 2,800,000 restricted shares of Avalon Oil and Gas, Inc. ("Avalon") for $0.089 per share, or approximately ¥1.5 million ($250,000). Since the restriction for the shares is for two years, the Company was able to acquire the shares at 50% of the market value. As a result, Recon owns 32.22% of Avalon's outstanding shares. The investment was accounted for using the equity method and no gain or loss from equity investment was recorded for the year ended June 30, 2013 due to immateriality. As of December 31, 2013, Recon owned 24.98% of Avalon's outstanding shares due to Avalon issuing more shares. Avalon is an independent US domestic oil and natural gas producer listed on the OTCBB under the ticker symbol AOGN. Avalon is building a portfolio of oil and gas producing properties to generate asset growth. Since Avalon's operating results for six months ended December 31, 2013 were not available as of the filing date, the Company used Avalon's operating results from July to September as the best estimate to calculate its investment loss. For the three and six months ended December 31, 2013, Avalon had revenue of approximately $40,000 and $80,000 (estimated), net loss of $0.2 million and $0.4 million (estimated), respectively. The Company recorded unrealized loss from investment of ¥360,466 ($58,992) and ¥735,080 ($120,300) for the three and six months ended December 31, 2013.

**NOTE 9. OTHER PAYABLES**

Other payables consisted of the following:

| Third Party | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Consulting services | ¥ | 1,199,716 | ¥ | 307,048 | $ | 50,250 |
| Due to ENI (A) | | 148,000 | | - | | - |
| Distributors and employees | | 580,648 | | 1,080,418 | | 176,816 |
| Others | | 36,327 | | 20,983 | | 3,434 |
| Total | ¥ | 1,964,691 | ¥ | 1,408,449 | $ | 230,500 |

(A) A former VIE of the Company, which ceased to be a VIE on December 16, 2010.

| Related Party | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Due to related parties (1) | ¥ | 2,860,824 | | 2,560,638 | $ | 419,063 |
| Expenses paid by the major shareholders | | 467,499 | | 527,098 | | 86,262 |
| Due to family member of one owner on behalf on Recon | | 716,000 | | 250,000 | | 40,914 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Due to management staff on behalf of Recon | | 195,352 | | 178,486 | | 29,210 |
| Total | ¥ | 4,239,675 | ¥ | 3,516,222 | $ | 575,449 |

(1) Includes an advance from Yabei Nuoda for RMB 61,291 and an advance from Xiamen Henda Haitek for RMB 2,499,347 to supplement the Company’s working capital. The advances are payable on demand and non-interest bearing.

F-12

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 10. TAXES PAYABLE**

Taxes payable consisted of the following:

| | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| VAT payable | ¥ | 2,802,890 | ¥ | 4,549,933 | $ | 744,621 |
| Business tax payable | | 75,865 | | 75,865 | | 12,416 |
| Enterprise income tax payable | | 3,850,288 | | 5,329,188 | | 872,150 |
| Other taxes payable | | 25,385 | | 92,418 | | 15,125 |
| Total taxes payable | ¥ | 6,754,428 | ¥ | 10,047,404 | $ | 1,644,312 |

**NOTE 11. SHORT-TERM BANK LOANS**

Short-term bank loans consisted of the following:

| | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Communication Bank, 6.6% annual interest, due on November 15, 2014 | ¥ | 3,090,000 | ¥ | 3,090,000 | ¥ | 505,695 |
| Communication Bank, 6.6% annual interest, due on November 15, 2014 | | 1,910,000 | | 1,910,000 | | 312,582 |
| Beijing Bank,5.75% annual interest, due on February 25, 2014 | | 1,200,000 | | 840,000 | | 137,471 |
| Beijing Bank, 5.75 % annual interest, due on February 27, 2014 | | 600,000 | | 420,000 | | 68,735 |
| Beijing Bank, 5.75 % annual interest, due on April 9, 2014 | | 1,200,000 | | 1,200,000 | | 196,386 |
| Beijing Bank, 5.75 % annual interest, due on April 16, 2014 | | 900,000 | | 900,000 | | 147,290 |
| Beijing Bank,5.75 % annual interest, due on March 11, 2014 | | 1,100,000 | | 1,100,000 | | 180,021 |
| Industrial and commercial bank, floating interest rate at 6.3%, due on July 28, 2014 | | - | | 3,060,000 | | 500,786 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Industrial and commercial bank, floating interest rate at 6.3%, due on August 8, 2014 | | - | | 1,000,000 | | 163,655 |
| Industrial and commercial bank, floating interest rate at 6.3%, due on February 24, 2014 | | - | | 3,000,000 | | 490,966 |
| Industrial and commercial bank, floating interest rate at 6.3%, due on June 12, 2014 | | - | | 2,840,000 | | 464,782 |
| Total short-term bank loans | ¥ | 10,000,000 | ¥ | 19,360,000 | $ | 3,168,369 |

Interest expense for short-term bank loans was ¥272,284 and ¥257,085 ($42,073) for the three months ended December 31, 2012 and 2013, respectively.

Interest expense for short-term bank loans was ¥746,409 and ¥476,757 ($78,024) for the six months ended December 31, 2012 and 2013, respectively.

**NOTE 12. SHORT-TERM BORROWINGS**

Short-term borrowings are generally extended upon maturity and consisted of the following:

F-13

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

| Short-term borrowings due to non-related parties: | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Short-term borrowing, 6% annual interest, due on November 9, 2013 | ¥ | 70,375 | ¥ | - | $ | - |
| Short-term borrowings with no interest, beginning April 22, 2013, due on April 21, 2014 | | 500,000 | | 460,000 | | 75,281 |
| Total short-term borrowings due to non-related parties | ¥ | 570,375 | ¥ | 460,000 | $ | 75,281 |

Interest expense for short-term borrowings due to non-related parties was ¥28,606 and ¥469 ($77) for the three months ended December 31, 2012 and 2013, respectively.

Interest expense for short-term borrowings due to non-related parties was ¥67,634 and ¥1,525 ($250) for the six months ended December 31, 2012 and 2013, respectively.

| Short-term borrowings due to related parties: | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Due-on-demand borrowings from Founders, no interest | ¥ | 6,377 | ¥ | - | $ | - |
| Short-term borrowing from a Founder's family member, 6% annual interest, matures and paid off by December 21, 2013 | | 3,653,906 | | - | | - |
| Short-term borrowing from a Founder's family member, 6% annual interest, matures and paid off by November 29, 2013 | | 1,610,000 | | - | | - |
| Short-term borrowings from Xiamen Huasheng Haitian Computer Network Co. Ltd., no interest, due on November 14, 2014 | | 200,000 | | 200,000 | | 32,731 |
| Short-term borrowings from management, 6% annual interest, matures and paid off by December 7, 2013 | | 32,996 | | - | | - |
| Total short-term borrowings due to related parties | ¥ | 5,503,279 | ¥ | 200,000 | $ | 32,731 |

Interest expense for short-term borrowings due to related parties was ¥58,790 and ¥910 ($149) for the three months ended December 31, 2012 and 2013, respectively.

Interest expense for short-term borrowings due to related parties was ¥113,907 and ¥1,441 ($236) for the six months ended December 31, 2012 and 2013, respectively.

**Note 13 Warrants liability**

In connection with the stock offering in November 2013, the Company issued warrants to certain institutional investors and placement agent to purchase 218,600 ordinary shares (see details in Note 14).

According to ASC 815-40, if the strike price of the warrants is denominated in a currency other than the Company's functional currency, the warrants are not considered indexed to the entity's own stock. The Company's functional currency is RMB and the strike price of the warrants is denominated in USD, as a result, the warrants are classified as liabilities with all future changes in the fair value of these warrants recognized in earnings until such time as the warrants are exercised or expired.

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

These common stock purchase warrants do not trade in an active securities market, and as such, their fair value is estimated by using the Cox-Ross-Rubinstein (CRR) Binomial Model using the following assumptions:

| | December 31, 2013 | | November 29, 2013 | |
|---|---|---|---|---|
| Annual dividend yield | - | | - | |
| Exercised price | 5.38 | | 5.38 | |
| Underlying price at grant date | 3.86 | | 3.86 | |
| Expected life (years) | 3 | | 3 | |
| Risk-free interest rate | 0.78 | % | 0.56 | % |
| Expected volatility | 272 | % | 272 | % |

Expected volatility is based on the historical volatility of the Company's common stock. The Company has no reason to believe future volatility over the expected remaining life of these warrants is likely to differ materially from historical volatility. The expected life is based on the remaining term of the warrants. The risk-free interest rate is based on U.S. Treasury securities according to the remaining term of the warrants. The expected dividend yield was based on the Company's current and expected dividend policy.

The following table sets forth by level within the fair value hierarchy the warrants liability that was accounted at fair value on a recurring basis.

| | Fair Value Measurement at December 31, 2013 | | | Carrying Value at December 31, 2013 | Carrying Value at December 31, 2013 |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | RMB | USD |
| Warrants liability | ¥ - | ¥ 5,044,722 | ¥ - | ¥ 5,044,722 | $ 825,596 |

The following is a reconciliation of the beginning and ending balance of the assets and liabilities measured at fair value on a recurring basis for six months ended December 31, 2013:

For the six months ended December 31, 2013:

| | Changes in warrants liability | |
|---|---|---|
| | RMB | USD |
| Beginning balance - June 30, 2013 | ¥ - | $ - |
| Initial measurement of warrants liability on November 29, 2013 | 5,045,278 | 825,687 |
| Change in warrants liability from November 29, 2013 to December 31, 2013 | (556) | (91) |

| | | | | |
|---|---|---|---|---|
| Ending balance - December 31, 2013 | ¥ | 5,044,722 | $ | 825,596 |

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 14. SHAREHOLDERS' EQUITY**

***Stock offering*** On November 25, 2013, the Company entered into a securities purchase agreement ("Purchase Agreement") with certain institutional investors for the sale of 546,500 ordinary shares in a registered direct offering at the price of $4.81 per ordinary share (amended to $4.30 per ordinary share on November 29, 2013). The net cash proceeds received from the stock offering, after deducting placement agency fees and other associated fees, were ¥12,132,882 (approximately $2.0 million). In addition, warrants to purchase 163,950 ordinary shares in the aggregate were issued to the investors. The warrants will be exercisable immediately as of the date of issuance at an exercise price of $6.01 per ordinary share (amended to $5.38 per ordinary share on November 29, 2013) and expire three years from the date of issuance. The Company also issued warrants to purchase 54,650 ordinary shares to the placement agent ("Placement Agent Warrant"). The Placement Agent Warrants are on substantially the same terms as the warrants issued pursuant to the Purchase Agreement, except that these warrants are not exercisable for a period of six months and will expire three years from the initial exercise date.

In addition to the above warrants issued to the placement agent, the Company granted 170,000 shares of warrants on connection with its IPO offering, and none of these warrants was exercised during this period.

***Appropriated Retained Earnings*** - According to the Memorandum and Articles of Association, the Company is required to transfer a certain portion of its net profit, as determined under PRC accounting regulations, from current net income to the statutory reserve fund. In accordance with the PRC Company Law, companies are required to transfer 10% of their profit after tax, as determined in accordance with PRC accounting standards and regulations, to the statutory reserves until such reserves reach 50% of the registered capital or paid-in capital of the companies. As of June 30, 2013 and December 31, 2013, the balance of total statutory reserves was ¥3,023,231 and ¥4,655,550 ($761,906), respectively.

**NOTE 15. STOCK-BASED COMPENSATION**

***Stock-Based Awards Plan***

*2009 Options Plan* - The Company granted options to purchase 293,000 ordinary shares under the Stock Incentive 2009 Plan to its employees and non-employee directors on July 29, 2009. The options have an excise price of $6.00, equal to the IPO price of the Company's ordinary shares, and will vest over a period of five years, with the first 20% vesting on July 29, 2010. The options expire ten years after the date of grant, on July 29, 2019. The fair value was estimated on July 29, 2009 using the Binomial Lattice valuation model, with the following weighted-average assumptions:

| | | |
|---|---|---|
| Stock price at grant date | $ 6.00 | |
| Exercise price (per share) | $ 6.00 | |
| Risk free rate of interest*** | 4.6118 | % |
| Dividend yield | 0.0 | % |
| Life of option (years)** | 10 | |
| Volatility* | 78 | % |
| Forfeiture rate**** | 0 | % |

* Volatility is projected using the performance of PHLX Oil Service Sector index.
** The life of options represents the period the option is expected to be outstanding.

*** The risk-free interest rate is based on the Chinese international bond denominated in U.S. dollar, with a maturity that approximates the life of the option.
**** Forfeiture rate is the estimated percentage of options forfeited by employees by leaving or being terminated before vesting.

The Company recognizes compensation cost for awards with graded vesting on a straight-line basis over the requisite service period for the entire award. The grant date fair value of the options was ¥30.17 ($4.42) per share.

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*2012 Options Plan* The Company granted options to purchase 415,000 ordinary shares to its employees and non-employee director on March 26, 2012. The options have an excise price of $2.96, which was equal to the share price of the Company's ordinary shares at March 26, 2012, and will vest over a period of five years, with the first 20% vesting on March 26, 2013. The options expire ten years after the date of grant, on March 26, 2022.

The Company recognizes compensation cost for awards with graded vesting on a straight-line basis over the requisite service period for the entire award. The grant date fair value of the options was ¥10.06 ($1.49) per share.

The following is a summary of the stock options activity:

| Stock Options | Shares | Weighted Average Exercise Price Per Share | |
|---|---|---|---|
| Outstanding as of July 1, 2013 | 608,000 | $ | 3.93 |
| Granted | - | | - |
| Forfeited | (44,000) | | (3.93) |
| Exercised | - | | - |
| Outstanding as of December 31, 2013 | 564,000 | $ | 3.93 |

The following is a summary of the status of options outstanding and exercisable at December 31, 2013:

| Outstanding Options | | | | Exercisable Options | | | |
|---|---|---|---|---|---|---|---|
| Average Exercise Price | | Number | Average Remaining Contractual life (Years) | Average Exercise Price | | Number | Average Remaining Contractual life (Years) |
| $ | 6.00 | 193,000 | 5.58 | $ | 6.00 | 154,400 | 5.58 |
| $ | 2.96 | 371,000 | 8.24 | $ | 2.96 | 74,200 | 8.24 |

For the six months ended December 31, 2013, the Company has granted restricted shares of common stock to senior management and consultants as follow:

On October 31, 2013, the Company issued 30,000 restricted shares to a consulting firm for consulting services. The total value amounted to ¥407,972 ($66,420), based on the stock closing price of $2.21 at September 30, 2013.

On December 13, 2013, the Company granted 95,181 restricted shares to Mr. Yin Shenping and 135,181 restricted shares to Mr. Chen Guangqiang at an aggregate value of ¥4,207,496 ($688,782), based on the stock closing price of $2.99 at December 13, 2013. These restricted shares will be vested over three years with one third of the shares vesting every year from the grant date. Share-based compensation expense recorded for restricted shares granted were ¥66,229($10,842) for the three and six months ended December 31, 2013. Total unrecognized share-based compensation expense for these shares as of December 31, 2013 was approximately ¥4.1 million ($0.7 million), which are expected to be recognized over a weighted average period of approximately 2.95 years.

The Share-based compensation expense recorded for stock options granted were ¥452,348 and ¥414,326 ($67,767) for the three months ended December 31, 2012 and 2013, respectively. The total share-based compensation expense recorded for stock options granted were ¥907,153 and ¥895,509 ($146,555) for the six months ended December 31, 2012 and 2013, respectively. The total unrecognized share-based compensation expense for stock options as of December 31, 2013 was approximately ¥3.1 million ($0.5 million), which is expected to be recognized over a weighted average period of approximately 2.73 years.

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Following is a summary of the restricted stock grants:

| Restricted stock grants | Shares |
|---|---|
| Nonvested as of June 30, 2013 | - |
| Granted | 260,362 |
| Forfeited | - |
| Vested | (30,000) |
| Nonvested as of December 31, 2013 | 230,362 |

**NOTE 16. INCOME TAX**

The Company is not subject to any income taxes in the United States or the Cayman Islands and had minimal operations in jurisdictions other than the PRC. BHD and Nanjing Recon are subject to PRC's income taxes as PRC domestic companies. For the calendar years 2012 and 2013, Nanjing Recon is subject to an income tax rate of 15%.

As approved by the domestic tax authority in the PRC, BHD was recognized as a government-certified high technology company on November 25, 2009 and is subject to an income tax rate of 15% through November 2015.

Deferred tax assets are comprised of the following:

| | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| Allowance for doubtful receivables | ¥ | 1,006,721 | ¥ | 1,038,932 | $ | 170,027 |
| Total deferred income tax assets | ¥ | 1,006,721 | ¥ | 1,038,932 | $ | 170,027 |

The Company's tax provision (benefit) is comprised of the following:

| | For the three months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 RMB | | 2013 RMB | | 2013 U.S. Dollars | |
| Current income tax provision | ¥ | 448,908 | ¥ | 1,295,941 | $ | 212,088 |
| Deferred income taxes benefit | | (25,600) | | (44,079) | | (7,214) |
| Provision for income tax | ¥ | 423,308 | ¥ | 1,251,862 | $ | 204,874 |

F-18

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

| | For the six months ended December 31, 2012 RMB | 2013 RMB | 2013 U.S. Dollars |
|---|---|---|---|
| Current income taxes | ¥ 448,908 | ¥ 1,491,400 | $ 244,076 |
| Deferred income taxes provision (benefit) | 6,024 | (32,211) | (5,272) |
| Provision for income tax | ¥ 454,932 | ¥ 1,459,189 | $ 238,804 |

**NOTE 17. NON-CONTROLLING INTEREST**

Non-controlling interest consisted of the following:

| | As of June 30, 2013 BHD RMB | Nanjing Recon RMB | Total RMB | Total U.S. Dollars |
|---|---|---|---|---|
| Paid-in capital | ¥ 1,651,000 | ¥ 200,000 | ¥ 1,851,000 | $ 299,118 |
| Unappropriated retained earnings | 2,717,231 | 2,665,337 | 5,382,568 | 869,812 |
| Accumulated other comprehensive loss | (18,793) | (13,784) | (32,577) | (5,265) |
| Total non-controlling interest | ¥ 4,349,438 | ¥ 2,851,553 | ¥ 7,200,991 | $ 1,163,665 |

| | As of December 31, 2013 BHD RMB | Nanjing Recon RMB | Total RMB | Total U.S. Dollars |
|---|---|---|---|---|
| Paid-in capital | ¥ 1,651,000 | ¥ 200,000 | ¥ 1,851,000 | $ 302,926 |
| Unappropriated retained earnings | 3,170,480 | 3,137,068 | 6,307,548 | 1,032,264 |
| Accumulated other comprehensive loss | (10,856) | (5,965) | (16,822) | (2,753) |
| Total non-controlling interest | ¥ 4,810,624 | ¥ 3,331,103 | ¥ 8,141,726 | $ 1,332,437 |

**NOTE 18. CONCENTRATIONS**

For the three months ended December 31, 2012 and 2013, the two largest customers, China National Petroleum Corporation ("CNPC") and China Petroleum & Chemical Corporation Limited ("SINOPEC"), represented 22.6%, 58.6% and 50.7%, 14.0% of the Company's revenue, respectively.

For the six months ended December 31, 2012 and 2013, the two largest customers, China National Petroleum Corporation ("CNPC") and China Petroleum & Chemical Corporation Limited ("SINOPEC"), represented 28.2%, 51.1% and 48.04%, 18.01% of the Company's revenue, respectively.

For the three and six months ended December 31, 2012, one supplier, Hebei Huanghua Xiangtong Technical Co. Ltd, accounted for 23% and 27% of the company's total purchases. For the three and six months ended December 31, 2013, four major suppliers accounted for 52.7% and 48.8% of the company's total purchases

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE19. COMMITMENTS AND CONTINGENCY**

**(a) Office Leases**

The Company leased three offices in Beijing (two for BHD; one for Recon-JN), one office in Jining for Recon-JN and one office in Nanjing for Nanjing Recon. Future payments under such leases are as follows as of December 31, 2013:

| | Twelve months ending December 31, Office lease payment | | | |
|---|---|---|---|---|
| | RMB | | U.S. Dollars | |
| 2014 | ¥ | 1,282,400 | $ | 209,872 |
| 2015 | | 100,000 | | 16,366 |
| Total | ¥ | 1,382,400 | $ | 226,237 |

**(b) Contingency**

The Labor Contract Law of the PRC requires employers to assure the liability of severance payments if employees are terminated and have been working for the employers for at least two years prior to January 1, 2008. The employers will be liable for one month of severance pay for each year of the service provided by the employees. As of December 31, 2013, the Company estimated its severance payments of approximately ¥1.2 million ($0.2 million) which has not been reflected in its unaudited condensed consolidated financial statements because the Company has determined that the likelihood to make these payments is remote.

**NOTE 20. RELATED PARTY TRANSACTIONS AND BALANCES**

***Sales to related parties*** sales to related parties consisted of the following:

| | For the three months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | 2013 | |
| | RMB | | RMB | | U.S. Dollars | |
| Beijing Yabei Nuoda Science and Technology Co. Ltd. | ¥ | 1,644,470 | ¥ | 1,242,073 | $ | 203,272 |
| Xiamen Henda Haitian computer network Inc | | 555,556 | | 384,615 | | 62,944 |
| Revenues from related parties | ¥ | 2,200,026 | ¥ | 1,626,688 | $ | 266,216 |

| | For the six months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | 2013 | |
| | RMB | | RMB | | U.S. Dollars | |
| Beijing Yabei Nuoda Science and Technology Co. Ltd. | ¥ | 2,176,521 | ¥ | 1,358,546 | $ | 222,333 |
| Beijing Adaer Oil Technology Co., Ltd. | | - | | - | | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| Xiamen Henda Haitian computer network Inc | | 555,556 | | 683,760 | | 111,901 |
| Revenues from related parties | ¥ | 2,732,077 | ¥ | 2,042,306 | $ | 334,234 |

***Purchases from related parties*** purchases from related parties consisted of the following:

F-20

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

| | For the three months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | 2013 | |
| | RMB | | RMB | | U.S. Dollars | |
| Huanghua Xiang Tong Manufacture | ¥ | 4,836,207 | ¥ | - | $ | - |
| Xiamen Huangsheng Hitek Computer Network Co. Ltd. | | 597,863 | | - | | - |
| Purchase from related parties | ¥ | 5,434,070 | ¥ | - | $ | - |

| | For the six months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | 2013 | | 2013 | |
| | RMB | | RMB | | U.S. Dollars | |
| Huanghua Xiang Tong Manufacture | ¥ | 7,331,353 | ¥ | - | $ | - |
| Xiamen Huangsheng Hitek Computer Network Co. Ltd. | | 597,863 | | - | | - |
| Purchase from related parties | ¥ | 7,929,216 | ¥ | - | $ | - |

***Leases from related parties* -** The Company has various agreements for the lease of office space owned by the Founders and their family members. The terms of the agreement state that the Company will continue to lease the property for two years at a monthly rent of ¥93,333 with the annual rental expense at approximately ¥1.1 million ($0.2 million).

***Short-term borrowings from related parties*** - The Company borrowed ¥5,503,279 and ¥200,000 ($32,731) from the Founders, their family members and senior officers as of June 30, 2013 and December 31, 2013, respectively. For the specific terms and interest rates of the borrowings, please see Note 12.

***Trade accounts payable to related parties* -** The Company owed ¥3,994,718 and ¥0 to one related party as of June 30, 2013 and December 31, 2013. As of December 31, 2013, BHD was no longer a related party to this supplier.

***Expenses paid by the owner on behalf of Recon* -** One owner of Nanjing Recon, Mr. Yin and the major owner of BHD, Mr. Chen paid certain operating expense for the Company. As of June 30, 2013 and December 31, 2013, ¥467,499 and ¥527,098($86,262) was due to them, respectively.

**NOTE 21. Variable Interest Entities**

The Company reports its VIEs' portion of consolidated net income and stockholders' equity as non-controlling interests in the condensed consolidated financial statements.

**RECON TECHNOLOGY, LTD**
**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Summary information regarding consolidated VIEs is as follows:

| | June 30, 2013 RMB | | December 31, 2013 RMB | | December 31, 2013 U.S. Dollars | |
|---|---|---|---|---|---|---|
| ASSETS | | | | | | |
| Current Assets | | | | | | |
| Cash and cash equivalents | ¥ | 10,341,778 | ¥ | 8,934,932 | $ | 1,462,250 |
| Trade accounts receivable, net | | 57,393,144 | | 84,530,402 | | 13,833,857 |
| Notes receivable | | 2,578,855 | | - | | - |
| Purchase advances | | 17,862,507 | | 17,524,066 | | 2,867,908 |
| Other assets | | 29,974,454 | | 36,230,550 | | 5,929,325 |
| Total current assets | ¥ | 118,150,738 | ¥ | 147,219,950 | $ | 24,093,340 |
| Non-current assets | | 1,705,940 | | 1,441,876 | | 235,971 |
| Total Assets | ¥ | 119,856,678 | ¥ | 148,661,826 | $ | 24,329,311 |
| LIABILITIES | | | | | | |
| Trade accounts payable | ¥ | 11,378,883 | ¥ | 23,101,652 | $ | 3,780,710 |
| Taxes payable | | 6,754,428 | | 10,047,403 | | 1,644,312 |
| Other liabilities | | 24,770,161 | | 29,139,023 | | 4,768,759 |
| Total current liabilities | | 42,903,472 | | 62,288,078 | | 10,193,781 |
| Total Liabilities | ¥ | 42,903,472 | ¥ | 62,288,078 | $ | 10,193,781 |

The financial performance of VIEs reported in the condensed consolidated statement of income and comprehensive income for the three months ended December 31, 2013 includes revenues of ¥46,266,327 ($7,571,735), gross profit of ¥16,524,423 ($2,704,309), operating expenses of ¥6,487,564 ($1,061,725), other income of ¥210,386 ($34,431) and a net income of ¥8,995,372($1,472,141).

The financial performance of VIEs reported in the condensed consolidated statement of income and comprehensive income for the six months ended December 31, 2013 includes revenues of ¥57,779,037 ($9,455,852), gross profit of ¥21,815,513 ($3,570,227), operating expenses of ¥9,875,573 ($1,616,191), other income of ¥401,376 ($65,687) and a net income of ¥10,882,127($1,780,919).

F-22