

Sino Clean Energy Inc  
Form 10-Q  
November 13, 2008

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

FORM 10-Q

(Mark One)

Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of  
1934

For the quarterly period ended: September 30, 2008

Or

Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of  
1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51753

SINO CLEAN ENERGY INC.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of incorporation  
of origination)

75-2882833  
(I.R.S. Employer Identification Number)

Room 2205, Suite A, Zhengxin Building  
No. 5 Gaoxin 1st Road, Gao Xin District  
Xi'an, Shaanxi Province  
People's Republic of China  
(Address of principal executive offices)

N/A  
(Zip code)

(029) 8209-1099  
(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  No

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting  
company)  
company

Smaller reporting

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

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each issuer's classes of common stock, as of the latest practicable date:  
94,514,750 issued and outstanding as of November 12, 2008.

Transitional Small Business Disclosure Form (Check one): Yes  No

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 FOR QUARTER ENDED SEPTEMBER 30, 2008

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CAUTION REGARDING FORWARD-LOOKING INFORMATION

All statements contained in this Quarterly Report on Form 10-Q (“Form 10-Q”) for Sino Clean Energy Inc., other than statements of historical facts, that address future activities, events or developments are forward-looking statements, including, but not limited to, statements containing the words “believe,” “anticipate,” “expect” and words of similar import. These statements are based on certain assumptions and analyses made by us in light of our experience and our assessment of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate under the circumstances. However, whether actual results will conform to the expectations and predictions of management is subject to a number of risks and uncertainties that may cause actual results to differ materially.

Such risks include, among others, the following: national and local general economic and market conditions; our ability to sustain, manage or forecast our growth; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Consequently, all of the forward-looking statements made in this Form 10-Q are qualified by these cautionary statements and there can be no assurance that the actual results anticipated by management will be realized or, even if substantially realized, that they will have the expected consequences to or effects on our business operations. As used in this Form 10-Q, unless the context requires otherwise, “we” or “us” or “Registrant” or the “Company” means Sino Clean Energy Inc. and its subsidiaries.



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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SINO CLEAN ENERGY INC. AND SUBSIDIARIES

Consolidated Financial Statements  
For the Periods Ended September 30, 2008 and 2007

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Sino Clean Energy Inc. and Subsidiaries  
Consolidated Balance Sheets  
(Amounts expressed in U.S. Dollars)

## ASSETS

|  | September 30,<br>2008<br>(Unaudited) | December 31,<br>2007<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
| <b>Current assets</b>                                  |                                      |                                   |
| Cash and cash equivalent                               | \$ 2,533,999                         | \$ 2,832,132                      |
| Accounts receivable, net (Note 2(d))                   | 6,242,716                            | 1,068,303                         |
| Deposits and prepayments (Note 6)                      | 732,420                              | 2,542,929                         |
| Other receivables                                      | 160,829                              | 138,523                           |
| Prepaid land use right - current portion (Note 10)     | 38,845                               | 36,285                            |
| Government grant receivable (Note 7)                   | -                                    | 411,000                           |
| Assets on discontinued operation                       |                                      |                                   |
| Other receivable - related (Note 21 (b))               | -                                    | 141,795                           |
| Inventories (Note 8)                                   | 293,101                              | 40,959                            |
| <b>Total current assets</b>                            | <b>10,001,910</b>                    | <b>7,211,926</b>                  |
| Deferred debt issuance cost, net (Note 15)             | 209,519                              | -                                 |
| Property, plant and equipment, net (Note 9)            | 5,915,779                            | 5,435,804                         |
| Prepaid land use right - non current portion (Note 10) | 1,810,955                            | 1,718,744                         |
| Goodwill (Notes 3 and 11)                              | 410,869                              | -                                 |
| Intangible assets, net (Note 12)                       | 1,268                                | 1,478                             |
| <b>Total assets</b>                                    | <b>\$ 18,350,300</b>                 | <b>\$ 14,367,952</b>              |

## LIABILITIES AND SHAREHOLDERS' EQUITY

|   |                |                  |
|---|----------------|------------------|
| <b>Current liabilities</b>                    |                |                  |
| Accounts payable                              | \$ 47,043      | \$ 41,827        |
| Accrued expenses and other payables (Note 13) | 735,079        | 893,732          |
| Amount due to a director (Note 21(a))         | 1,178          | 8,527            |
| Obligations under capital leases (Note 14)    | 13,450         | -                |
| Taxes payable                                 | 150,031        | 130,332          |
| Deposit on sales of property (Note 21 (c))    | -              | 1,507,000        |
| <b>Total current liabilities</b>              | <b>946,781</b> | <b>2,581,418</b> |
| <b>Non-current liabilities</b>                |                |                  |
| Convertible debentures (Note 15)              | 383,856        | -                |
| Obligations under capital leases (Note 14)    | 4,265          | -                |
| <b>Total non-current liabilities</b>          | <b>388,121</b> | <b>-</b>         |



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|  |               |               |
|--|---------------|---------------|
| Total liabilities  | 1,334,902     | 2,581,418     |
| Minority interest  | -             | 352,789       |
| Commitments and Contingencies (Note 22)  |               |               |
| Shareholders' Equity   |               |               |
| Preferred stock, \$0.001 par value,<br>50,000,000 shares authorized,<br>nil issued and outstanding   | -             | -             |
| Common stock, \$0.001 par value,<br>200,000,000 shares authorized,<br>92,181,750 and 84,681,750 issued and outstanding<br>as of September 30, 2008 and December 31, 2007<br>respectively | 92,182        | 84,682        |
| Additional paid-in capital   | 11,312,205    | 9,153,174     |
| Retained earnings  | 3,166,608     | 686,482       |
| Statutory reserves (Note 18)   | 348,309       | 348,309       |
| Accumulated other comprehensive income   | 2,096,094     | 1,161,098     |
| Total shareholders' equity   | 17,015,398    | 11,433,745    |
| Total liabilities and shareholders' equity   | \$ 18,350,300 | \$ 14,367,952 |

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Sino Clean Energy Inc. and Subsidiaries  
Consolidated Statements of Income (Operations) and Other Comprehensive Income  
For the three months and nine months ended September 30, 2008 and 2007  
(Amounts expressed in U.S. Dollars)  
(Unaudited)

|   | Three months ended<br>September 30, |              | Nine months ended<br>September 30, |              |
|---|-------------------------------------|--------------|------------------------------------|--------------|
|   | 2008                                | 2007         | 2008                               | 2007         |
| Revenue   | \$ 3,419,941                        | \$ 234,639   | \$ 9,156,293                       | \$ 234,639   |
| Cost of goods sold                              | (2,297,227)                         | (181,563)    | (6,227,606)                        | (181,563)    |
| Gross profit                                    | 1,122,714                           | 53,076       | 2,928,687                          | 53,076       |
| Selling expenses                                | 3,106                               | 17,229       | 7,871                              | 19,009       |
| General and administrative expenses             | 204,915                             | 197,371      | 590,719                            | 330,282      |
| Income (loss) from operations                   | 914,693                             | (161,524)    | 2,330,097                          | (296,215)    |
| Other income (expenses)                         |                                     |              |                                    |              |
| Rental income, net of outgoings                 | 230                                 | -            | 79,843                             | -            |
| Interest income                                 | 8,026                               | 3,449        | 19,537                             | 13,372       |
| Commission income                               | 80,072                              | -            | 224,947                            | -            |
| Sundry income (expenses)                        | 78                                  | 6,471        | 26,921                             | (131)        |
| Other income (expenses)                         | -                                   | (7,601)      | -                                  | 137,339      |
| Gain on disposal of property (Note 21(c))       | 95                                  | -            | 33,095                             | -            |
| Government grant                                | 141,614                             | -            | 141,614                            | -            |
| Total other income                              | 230,115                             | 2,319        | 525,957                            | 150,580      |
| Income (loss) before provision for income taxes | 1,144,808                           | (159,205)    | 2,856,054                          | (145,635)    |
| Provision for income taxes (Note 19)            | 71                                  | -            | 24,779                             | -            |
| Net income (loss) before minority interest      | \$ 1,144,737                        | \$ (159,205) | \$ 2,831,275                       | \$ (145,635) |
| Less: Minority interest                         | -                                   | 11,099       | (351,149)                          | 21,190       |
| Net income (loss)                               | 1,144,737                           | (148,106)    | 2,480,126                          | (124,445)    |
| Other comprehensive income                      |                                     |              |                                    |              |
| Foreign currency translation adjustment         | 124,319                             | 116,066      | 934,996                            | 385,813      |
| Comprehensive income (loss)                     | \$ 1,269,056                        | \$ (32,040)  | \$ 3,415,122                       | \$ 261,368   |

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|   |            |             |            |             |
|---|------------|-------------|------------|-------------|
| <b>Weight average number of shares</b>          |            |             |            |             |
| - Basic and diluted                             | 92,181,750 | 84,681,750  | 92,181,750 | 84,681,750  |
| <b>Income (loss) per common share (Note 20)</b> |            |             |            |             |
| - Basic and diluted                             | \$ 0.0124  | \$ (0.0017) | \$ 0.0269  | \$ (0.0015) |

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Sino Clean Energy Inc. and Subsidiaries  
Consolidated Statements of Shareholders' Equity  
(Amount expressed in U.S. Dollars except number of shares)

|   | Common stock<br>(par value \$0.1208) |           | Additional<br>paid-in<br>capital | Statutory<br>capital<br>reserves | Statutory<br>welfare<br>reserves | (Accumulated<br>deficits) /<br>Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income |               | Total |
|---|--------------------------------------|-----------|----------------------------------|----------------------------------|----------------------------------|---|---|---------------|-------|
|   | Shares                               | Amount    |                                  |                                  |                                  |   | income  | Total         |       |
| Balance,<br>January 1, 2007<br>(audited)            | 84,681,750                           | \$ 84,682 | \$ 9,153,174                     | \$ 232,206                       | \$ 116,103                       | \$ (330,456)  | \$ 432,312                                      | \$ 9,688,021  |       |
| Net loss  | -                                    | -         | -                                | -                                | -                                | (124,445)   | -   | (124,445)     |       |
| Foreign<br>currency<br>translation gain             | -                                    | -         | -                                | -                                | -                                | -   | 385,813   | 385,813       |       |
| Balance,<br>September 30,<br>2007<br>(Unaudited)    | 84,681,750                           | \$ 84,682 | \$ 9,153,174                     | \$ 232,206                       | \$ 116,103                       | \$ (454,901)  | \$ 818,125                                      | \$ 9,949,389  |       |
| Net income  | -                                    | -         | -                                | -                                | -                                | 1,141,383   | -   | 1,141,383     |       |
| Foreign<br>currency<br>translation gain             | -                                    | -         | -                                | -                                | -                                | -   | 342,973   | 342,973       |       |
| Balance,<br>December 31,<br>2007 (audited)          | 84,681,750                           | \$ 84,682 | \$ 9,153,174                     | \$ 232,206                       | \$ 116,103                       | \$ 686,482  | \$ 1,161,098                                    | \$ 11,433,745 |       |
| Issuance of<br>share                                | 7,500,000                            | 7,500     | 1,141,351                        | -                                | -                                | -   | -   | 1,148,851     |       |
| Beneficial<br>conversion<br>feature of<br>debenture | -                                    | -         | 986,921                          | -                                | -                                | -   | -   | 986,921       |       |
| Warrants issued<br>to placement<br>agent            | -                                    | -         | 30,759                           | -                                | -                                | -   | -   | 30,759        |       |
| Net income  | -                                    | -         | -                                | -                                | -                                | 2,480,126   | -   | 2,480,126     |       |
| Foreign<br>currency<br>translation gain             | -                                    | -         | -                                | -                                | -                                | -   | 934,996   | 934,996       |       |
| Balance,<br>September 30,<br>2008                   | 92,181,750                           | \$ 92,182 | \$ 11,312,205                    | \$ 232,206                       | \$ 116,103                       | \$ 3,166,608  | \$ 2,096,094                                    | \$ 17,015,398 |       |

(Unaudited)



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Sino Clean Energy Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
(Amounts expressed in U.S. Dollars)  
(Unaudited)

|   | Period ended September |              |
|---|------------------------|--------------|
|   | 30,                    |              |
|   | 2008                   | 2007         |
| <b>Cash flows from operating activities:</b>                                  |                        |              |
| Net income  | \$ 2,480,126           | \$ (124,445) |
| Adjustments to reconcile net income to cash provided by operating activities: |                        |              |
| Minority interest   | 351,149                | (21,190)     |
| Net income from discontinued operations                                       | -                      | (137,339)    |
| Amortization of deferred debenture expenses                                   | 8,399                  | -            |
| Discount on debenture   | 35,127                 | -            |
| Depreciation and amortization   | 175,399                | 40,607       |
| Gain on disposal of property  | (33,095)               | -            |
| (Increase) decrease in assets:  |                        |              |
| Accounts receivable   | (4,923,476)            | (248,645)    |
| Deposits and prepayments  | 1,921,371              | (2,633,573)  |
| Other receivables   | (14,227)               | 207,656      |
| Prepaid land use rights   | 28,031                 | -            |
| Receipt from government grant   | 411,000                | -            |
| Other receivables - discontinued operations                                   | 141,795                | -            |
| Inventories   | (240,670)              | (28,160)     |
| Increase (decrease) in liabilities:   |                        |              |
| Accounts payable  | 2,187                  | 148,429      |
| Advance from customers  | -                      | 602,864      |
| Accrued expenses and other payable  | (198,852)              | 105,435      |
| Taxes payables  | 10,143                 | 37,730       |
| Net cash provided by discontinued operations                                  | -                      | 69,729       |
| Net cash provided from (used in) operating activities                         | 154,407                | (1,980,902)  |
| <b>Cash flows from investing activities:</b>                                  |                        |              |
| Amount due from a director  | -                      | 133,255      |
| Purchase of property, plant and equipment                                     | (2,791,475)            | (1,187,120)  |
| Net cash used in investing activities   | (2,791,475)            | (1,053,865)  |
| <b>Cash flows from financing activities:</b>                                  |                        |              |
| (Payment to ) advance from a director   | (7,427)                | 74,515       |
| Proceeds from disposal of property  | 1,025,437              | -            |
| Issuance of convertible debenture   | 1,148,491              | -            |
| Capital element of capital lease  | 44,423                 | -            |
| Obligations under capital leases  | (27,318)               | -            |
| Net cash provided by financing activities                                     | 2,183,606              | 74,515       |
| Effect of foreign currency translation  | 155,329                | 120,880      |

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|   |              |              |
|---|--------------|--------------|
| Net decrease in cash and cash equivalents                 | (298,133)    | (2,839,372)  |
| Cash and cash equivalents, beginning of period            | 2,832,132    | 4,450,557    |
| Cash and cash equivalents, end of period                  | \$ 2,533,999 | \$ 1,611,185 |
| Supplemental Disclosure Information                       |              |              |
| Interest paid   | \$ -         | \$ -         |
| Income taxes paid   | \$ -         | \$ -         |
| Major non-cash transaction                                |              |              |
| Issuance of share in exchange of equity interest (Note 3) | \$ 1,500,000 | \$ -         |

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1. CORPORATION REORGANIZATION AND BUSINESS ACTIVITIES

Sino Clean Energy Inc. (the “Company”) was originally incorporated in Texas as “Discount Mortgage Services, Inc.” on July 11, 2000. In November 2001, the Company changed its name to Endo Networks, Inc. and was redomiciled to the State of Nevada in December 2002. On January 4, 2007, the Company changed its name to “China West Coal Energy Inc.” Further on August 15, 2007, the Company changed its name to “Sino Clean Energy Inc”.

Prior to December 2006, the Company had principally been engaged in production and sales of coal-polymer (“COPO”) resin products. In December 2006, the Company decided to cease its operations in manufacturing COPO products and shift all its resources towards the production and sale of “coal-water mixture” products.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of presentation and consolidation

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

The consolidated financial statements include the financial statements of the Company, its wholly owned subsidiary Hangson Ltd. (“Hangson”), its variable interest entity (VIE) Shaanxi Suo’ang Biological Science & Technology Co., Ltd. (“Suo’ang Biological”) and Suo’ang Biological’s subsidiary, Shaanxi Suo’ang New Energy Enterprise Co., Ltd. (“Suo’ang New Energy”). All significant inter-company transactions and balances among the Company, Hangson, Suo’ang Biological and Suo’ang New Energy are eliminated upon consolidation.

b. Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates. Significant estimates include estimates of accruals and determination of fair values for assets disposed.

c. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, bank deposits and deposit in an escrow account. Deposit in the escrow account was \$885,057 as of September 30, 2008. The fund held in the escrow account was released to the Company in late October 2008.

d. Accounts receivable

Accounts receivables are recognized and carried at original invoiced amount less an allowance for any uncollectible accounts.

The Company uses the aging method to estimate the valuation allowance for anticipated uncollectible receivable balances. Under the aging method, bad debts determined by management are based on historical experience as well as the current economic climate and are applied to customers' balances categorized by the number of months the underlying invoices have remained outstanding. The valuation allowance balance is adjusted to the amount computed as a result of the aging method. When facts subsequently become available to indicate that an adjustment to the



allowance should be made, this is recorded as a change in estimate in the current period. As of September 30, 2008 and December 31, 2007, accounts receivable were net of allowances of \$5,747 and \$5,368, respectively.

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e. Inventories

Inventories are stated at the lower of cost, as determined on a weighted average basis, or net realizable value. Costs of inventories include purchase and related costs incurred in bringing the products to their present location and condition.

f. Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated depreciation and amortization. Gains or losses on disposals are reflected as gain or loss in the year of disposal. The cost of improvements that extend the life of plant, property and equipment are capitalized. These capitalized costs may include structural improvements, equipment and fixtures. All ordinary repair and maintenance costs are expensed as incurred.

Depreciation or amortization for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets as follows:

|                        |  |
|------------------------|--|
| Buildings              | the shorter of the useful life or the lease term |
| Leasehold improvements | the shorter of the useful life or the lease term |
| Plant and machinery    | 10 years   |
| Office equipment       | 5 years  |
| Motor vehicles         | 3 years  |

g. Construction in progress

Construction in progress includes direct costs of factory buildings. Construction in progress is not depreciated until such time as the assets are completed and put into operational use.

h. Prepaid land use rights

Prepaid land use right is expensed over the term of 50 years.

i. Goodwill

The Company accounts for acquisitions of business in accordance with SFAS No. 141 “Business Combinations”, which may result in the recognition of goodwill. Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations accounted for under the purchase method. Goodwill is not subject to amortization but will be subject to periodic evaluation for impairment. Goodwill is stated in the consolidated balance sheet at cost less accumulated impairment loss.

j. Impairment

(i) Long-lived Assets

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Impairment is considered to exist if the total estimated future cash flows on an undiscounted basis are less than the carrying amount of the assets, including goodwill, if any. An impairment loss is measured and recorded based on discounted estimated future cash flows. In

estimating future cash flows, assets are grouped at the lowest level for which there is identifiable cash flows that are largely independent of future cash flows from other asset groups.

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(ii) Goodwill

Impairment of goodwill is tested at least annually at the reporting unit. The test consists of two steps. Firstly, the Company identifies potential impairment by comparing the fair value of the reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired. Secondly, if there is impairment identified in the first step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No 141, "Business Combinations". If the carrying value of a reporting unit exceeds its estimated fair value, the Company compares the implied fair value of the reporting unit's goodwill to its carrying amount, and any excess of the carrying value over the fair value is charged to earnings. The Company's fair value estimates are based on numerous assumptions and it is possible that actual fair value will be significantly different than the estimates.

k. Comprehensive income

SFAS No. 130, Reporting Comprehensive Income, requires disclosure of all components of comprehensive income and loss on an annual and interim basis. Comprehensive income and loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The Company had other comprehensive income of \$934,996 and \$385,813 for the periods ended September 30, 2008 and 2007, respectively. The other comprehensive income arose from the changes in foreign currency exchange rate.

l. Fair value of financial instruments

The Company believes that the carrying values of its cash and cash equivalents, accounts receivable, accounts payable, other receivables and other payables as of September 30, 2008 and December 31, 2007 approximate to their respective fair values due to the short-term nature of those instruments.

m. Revenue recognition

Revenues of the Company arising from sales of coal water mixture.

Sales are recognized when the following four revenue criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectibility is reasonably assured. Revenues are presented net of value added tax (VAT). No return allowance is made as products are normally not returnable upon acceptance by the customers.

n. Income (loss) per common share

Income (loss) per common share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the periods.

o. Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires an asset and liability approach for financial accounting and reporting for income taxes and allows recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts

used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain.

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p. Foreign currency translation

The reporting currency of the Company is the United States Dollars. All assets and liabilities accounts have been translated into United States Dollars using the current exchange rate at the balance sheet date. Capital stock is recorded at historical rates. Revenue and expenses are translated using the average exchange rate in the period. The resulting gain and loss has been reported as other comprehensive income within the shareholder's equity.

q. Related parties

Parties are considered to be related to the Company if the parties, directly or indirectly, through one or more intermediaries, control, are controlled by, or are under common control with the Company. Related parties also include principal owners of the Company, its management, members of the immediate families of principal owners of the Company and its management and other parties with which the Company may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

r. Recently issued accounting pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), to define fair value, establish a framework for measuring fair value in accordance with generally accepted accounting principles and expand disclosures about fair value measurements. SFAS 157 requires quantitative disclosures using a tabular format in all periods (interim and annual) and qualitative disclosures about the valuation techniques used to measure fair value in all annual periods. The provisions of this Statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is required to adopt the provisions of this statement as of January 1, 2008. The Company determined that the adoption of this standard had no material effect on its financial statements.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - An amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS 158"). This Statement enhances disclosure regarding the funded status of an employer's defined benefit postretirement plan by (a) requiring companies to include the funding status in comprehensive income, (b) recognize transactions and events that affect the funded status in the financial statements in the year in which they occur, and (c) at a measurement date of the employer's fiscal year-end. Statement No. 158 effective for fiscal year ending after December 15, 2008, and is not expected to apply to the Company.

In February 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair values. SFAS 159 is effective for fiscal years after November 15, 2007. The Company determined that the adoption of this standard had no material effect on its financial statements.

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In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), “Business Combinations” (“FAS 141R”). FAS 141R replaces Statement of Financial Accounting Standards No. 141, “Business Combinations” (“FAS 141”). Although it retains the fundamental requirement in FAS 141 that the acquisition method of accounting be used for all business combinations, FAS 141R establishes principles and requirements for how the acquirer in a business combination (a) recognizes and measures the assets acquired, liabilities assumed and any noncontrolling (“minority”) interest in the acquiree, (b) recognizes and measures the goodwill acquired in a business combination or a gain from a bargain purchase and (c) determines what information to disclose regarding the business combination. FAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the Company’s 2009 fiscal year. The Company is currently assessing the potential effect of FAS 141R on its financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, “Noncontrolling (“minority”) Interests in Consolidated Financial Statements” (“FAS 160”). FAS 160 establishes accounting and reporting standards for the noncontrolling (“minority”) interest in a subsidiary, commonly referred to as minority interest. Among other matters, FAS 160 requires (a) the noncontrolling (“minority”) interest be reported within equity in the balance sheet and (b) the amount of consolidated net income attributable to the parent and to the noncontrolling (“minority”) interest to be clearly presented in the statement of income. FAS 160 is effective for the Company’s 2009 fiscal year. FAS 160 is to be applied prospectively, except for the presentation and disclosure requirements, which shall be applied retrospectively for all periods presented. The Company is currently assessing the potential effect of FAS 160 on its financial statements.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities – An Amendment of FASB Statement No. 133” (“SFAS No. 161”), which changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. This statement will be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 (that is, fiscal 2009 for the Company). The Company does not expect that this Statement will have an effect on the Company’s consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles”. This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). This Statement is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not expect that this Statement will have an effect on the Company’s consolidated financial statements.

In May 2008, the FASB issued SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60”. This Statement interprets Statement 60, “Accounting and Reporting by Insurance Enterprises” and amends existing accounting pronouncements to clarify their application to the financial guarantee insurance contracts included within the scope of this Statement. This Statement requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how Statement 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. This Statement is effective for financial statements issued for fiscal years

beginning after December 15, 2008 (that is, fiscal 2009 for the Company), and all interim periods within those fiscal years. The Company does not expect that this Statement will have an effect on the Company's consolidated financial statements.

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## 3. ACQUISITION

On June 30, 2008, the Company and its wholly owned subsidiary, Hangson, entered into a Securities Purchase Agreement (the "Agreement") with the minority shareholder of Suo'ang New Energy. Pursuant to the Agreement, the minority shareholder transferred his 20% ownership of Suo'ang New Energy to Hangson in exchange for 7,500,000 shares (the "Shares") of the Company's restricted common stock. Suo'ang Biological, the Company's VIE, owns 80% of Suo'ang New Energy. Pursuant to the terms of the Agreement, the minority shareholder agreed to waive any and all rights that he may have to any distributions and or payments from Suo'ang New Energy beginning January 1, 2008. On June 30, 2008, the transaction contemplated under the Agreement was completed upon approval by the Chinese local government authorities. As a result, Suo'ang New Energy is now 100% controlled by the Company.

The total purchase price was \$1,148,851, by issuance of the Company's restricted common stock based on the per share value on the acquisition date.

The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price for this acquisition, as of the date of acquisition, is as follows:

|   |              |
|---|--------------|
| Cash acquired   | \$ 3,712,020 |
| Accounts receivable, net of allowance                         | 3,459,196    |
| Property, plant and equipment                                 | 3,100,935    |
| Inventory   | 76,443       |
| Prepaid land use right  | 1,848,416    |
| Goodwill  | 410,869      |
| Other assets acquired   | 2,422,836    |
| Total assets acquired   | 15,030,715   |
| Liabilities assumed   | (10,929,937) |
|   | 4,100,778    |
| Less: Interest held by Suo'ang by way of initial contribution | (2,951,927)  |
|   | \$ 1,148,851 |

At the date of acquisition of the minority interest of Suo'ang New Energy, management made its best estimate of the allocations of the fair value assigned to assets and has categorized the value of \$410,869 attributed to goodwill for the acquisition. A final analysis and determination will be made during year ending December 31, 2008.

The following table sets forth the unaudited pro forma results of operations of the Company as if the additional acquisition of the 20% interest in Suo'ang New Energy had occurred at the beginning of the year. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of the periods presented or that not be obtained in the future.

## Unaudited Pro Forma Results

|   |    |           |
|---|----|-----------|
| Net income attributable to shareholders | \$ | 1,686,538 |
|---|----|-----------|



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## 4. CONCENTRATION OF CREDIT RISK

- a. Financial instruments that potentially expose the Company to concentrations of credit risk, consist of cash and cash equivalents and accounts receivable. The Company performs ongoing evaluations of their cash position and credit evaluations to ensure collections and minimize losses.
- b. As of September 30, 2008 and 2007, the Company's bank deposits were all placed with banks in the PRC where there is currently no rule or regulation in place for obligatory insurance of bank accounts.
- c. For the periods ended September 30, 2008 and 2007, all of the Company's sales arose in the PRC. All accounts receivable as of September 30, 2008 and 2007 also arose in the PRC.
- d. Details of the customers accounting for 10% or more of the Company's total sales for the periods ended September 30, 2008 and 2007 are as follows:

|           | Periods ended September 30, |            |
|-----------|-----------------------------|------------|
|           | 2008                        | 2007       |
| Company A | \$ 1,370,151                | \$ 196,384 |
| Company B | -                           | 52,990     |
| Company C | 1,197,573                   | -          |
| Company D | 1,144,546                   | -          |

The accounts receivable from the customers accounting for 10% or more of the Company's total sales represent 49.43% of the balance of the account at September 30, 2008. Accounts receivable at September 30, 2008 originated from the coal water mixture business. None of the accounts receivable originating from the COPO resin business accounted for 10% or more of the Company total sales.

## 5. CURRENT VULNERABILITY DUE TO CERTAIN CONCENTRATIONS

The Company's operations are all carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy.

The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in the North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

## 6. DEPOSITS AND PREPAYMENTS

Deposits and prepayments consist of the following:

|   | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Prepayment for construction in progress and machinery purchases | \$ 720,229            | \$ 908,561           |
| Purchase security deposit                                       | 4,400                 | 1,609,750            |
| Prepaid expenses  | 5,632                 | 22,600               |

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|       |            |              |
|-------|------------|--------------|
| Other | 2,159      | 2,018        |
|       | \$ 732,420 | \$ 2,542,929 |

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## 7. GOVERNMENT GRANT RECEIVABLE

The amount represents a subsidy from the Shaanxi Provincial Government. The subsidy is unconditional and was received in the first quarter of 2008.

## 8. INVENTORIES

Inventories consist of the following,

|                   | September 30,<br>2008 | December 31,<br>2007 |
|-------------------|-----------------------|----------------------|
| Raw materials     | \$ 245,555            | \$ 22,615            |
| Packing materials | 987                   | 1,751                |
| Work in progress  | 2,213                 | -                    |
| Finished goods    | 44,346                | 16,593               |
|                   | \$ 293,101            | \$ 40,959            |

## 9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following:

|   | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Construction in progress                        | \$ 2,682,282          | \$ 119,169           |
| Buildings                                       | 1,692,118             | 3,806,628            |
| Leasehold improvements                          | -                     | 232,900              |
| Plant and machinery                             | 1,708,749             | 1,596,161            |
| Office equipment                                | 70,028                | 65,414               |
| Motor vehicles                                  | 179,948               | 127,935              |
|   | 6,333,125             | 5,948,207            |
| Less: Accumulated depreciation and amortization | 417,346               | 512,403              |
|   | \$ 5,915,779          | \$ 5,435,804         |

Construction in progress included above was the construction of buildings, production lines and machinery for the coal-water mixture business.

The depreciation expenses on property, plant and equipment for the nine months ended September 30, 2008 and 2007 were \$175,095 and \$35,966, respectively.

## 10. PREPAID LAND USE RIGHT

The Company has recorded as prepaid land use rights the costs paid to acquire a long-term interest to utilize the land underlying the building and production facility for its coal-water mixture business. This type of arrangement is common for the use of land in the PRC. The prepaid land use rights are expenses on the straight-line method over the term of the land use rights of 50 years.

The amount expensed on prepaid land use right for the periods ended September 30, 2008 and 2007 was \$28,031 and \$4,377, respectively. The amount to be expensed on prepaid land use rights over each of the next five years and thereafter is \$193,070 per annum.

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## 11. GOODWILL

|   |            |
|---|------------|
| Balance as of December 31, 2007   | \$ -       |
| Arising from additional acquisition of Suo'ang New Energy on June 30, 2008 (Note 3) | 410,869    |
| Balance as of September 30, 2008  | \$ 410,869 |

## 12. INTANGIBLE ASSETS

Intangible assets consist of the following:

|                                | September 30,<br>2008 | December 31,<br>2007 |
|--------------------------------|-----------------------|----------------------|
| Accounting software            | \$ 2,097              | \$ 1,959             |
| Less: Accumulated amortization | (829)                 | (481)                |
|                                | \$ 1,268              | \$ 1,478             |

The amortization expenses on intangible assets for the periods ended September 30, 2008 and 2007 were \$304 and \$275, respectively.

## 13. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables consist of the following as of:

|                                  | September 30,<br>2008 | December 31,<br>2007 |
|----------------------------------|-----------------------|----------------------|
| Accrued operating expenses       | \$ 374,450            | \$ 471,988           |
| Prepaid land use right payable   | 143,165               | 133,731              |
| Accrued staff welfare            | 142,104               | 71,706               |
| Construction in progress payable | 12,831                | 90,140               |
| Non-interest bearing loan        | -                     | 68,627               |
| Advance from customer            | 58,665                | 54,800               |
| Other payables                   | 3,864                 | 2,740                |
|                                  | \$ 735,079            | \$ 893,732           |

## 14. OBLIGATIONS UNDER CAPITAL LEASES

|   | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Total minimum lease payments                              | \$ 17,715             | \$ -                 |
| Less: Current portion of obligations under capital leases | (13,450)              | -                    |
|   | \$ 4,265              | \$ -                 |





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15. CONVERTIBLE DEBENTURES

On September 16, 2008 and September 19, 2008, the Company sold \$1,335,650 in aggregate principal amount of its 18% secured convertible debentures (the “Debentures”) and issued warrants (the “Warrants”) to purchase up to 8,904,334 shares of common stock of the Company to institutional and other accredited investors in a private placement (the “Transactions”). The Company also issued warrants to Ancora Securities, Inc. as finder’s fee as follows: (i) for the Debentures sold on September 16, 2008, warrants to purchase up to 267,100 shares of common stock at an exercise price of \$0.25 per share and expiring on September 15, 2010, and (ii) for the Debentures sold on September 19, 2008, warrants to purchase up to 90,000 shares of common stock at an exercise price of \$0.25 per share and expiring on September 18, 2010.

The Debentures bear a fixed rate of interest at 18% per annum and mature one year from their issuance dates, provided that the principals and interests are due immediately upon an event of default, as such term is defined in the Debentures. The holders of the Debentures have the right at any time to convert all or part of the outstanding principal amount of the Debentures and any accrued and unpaid interest into common shares of the Company at the then effective conversion price, initially being \$0.15 per share. However, if the Company completes a Qualifying Financing Transaction (as defined in the Debentures) and the listing of its common stock on a Subsequent Market (as defined in the Debentures) on or before the Debentures mature, all interests due under the Debentures will be waived and all of the outstanding principal amount of Debentures will automatically convert into common shares. The Debentures are secured by a personal guarantee from the Company’s Chairman.

The Warrants entitle each investor to purchase up to a number of common shares (the “Warrant Shares”) equal to 100% of the number of common shares that would be issuable upon conversion of the Debentures purchased by such investor in the Transaction. The Warrants have an initial exercise price of \$0.15 per share. 25% of the Warrant Shares vest and are immediately exercisable upon issuance of the Warrants. Thereafter, up to 5% of the Warrant Shares will vest and become exercisable at the end of every one-month period beginning on October 31, 2008, until the sooner of the listing of the Company’s common stock on a Subsequent Market, or the repayment in full of the Debentures, or until 100% of the Warrant Shares are vested. Any portion of the Warrant Shares not vested prior to the earlier of the Subsequent Market listing or repayment of the Debentures shall be deemed void. The Warrants are exercisable for a period of three years from their issuance date.

The initial conversion price of the Debentures is subject to adjustments should the Company issue more shares of common stock or securities convertible into common stock, including rights, options or warrants to subscribe for common shares, for less than the initial conversion price and without offering the same to the investors in the Transaction. In the case of adjustments to the conversion price, the conversion price shall be adjusted to the consideration received or receivable by the Company for each share of common stock issued or issuable. The initial conversion price of the Debentures and the initial exercises price of the Warrants are also subject to adjustment for other customary adjustment events such as any stock dividend, stock split, reverse stock split or other similar transaction.

In connection with the Transactions, the Company’s Chairman entered into an escrow agreement (the “Escrow Agreement”) with the investors pursuant to which he has agreed to place a certain number of the Company’s common shares that he owns into escrow (the “Escrow Shares”). Under the terms of the Escrow Agreement, one-half of the Escrow Shares will be released back to the Chairman if the Company meets certain financial milestones described in the Escrow Agreement at the end of fiscal year ended December 31, 2008; otherwise, these Escrow Shares will be distributed to the investors in proportion to each investor’s purchase price in the Transaction. Likewise, the remaining half of the Escrow Shares will be released back to the Chairman if the Company meets certain financial milestones described in the Escrow Agreement at the end of fiscal year ended December 31, 2009; otherwise, these Escrow

Shares will be proportionately distributed to the investors.

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The fair value of the embedded conversion feature of the Debentures of \$986,921 was calculated using the intrinsic value method in accordance with EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments", limited to the amount of the proceeds allocated to the convertible instrument, and recorded in additional paid-in capital in the balance sheet. The discount resulting from recording the conversion feature of the Debentures is amortized from their date of issuance to their date of maturity.

The Company has evaluated the Warrants under SFAS 133, "Accounting for Derivatives", and EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock", and reported the fair value of the Warrants as equity instruments. The Warrants were valued using the Black-Scholes option pricing method with the following assumptions:

|                          |                       |                       |
|--------------------------|-----------------------|-----------------------|
| Issuance date:           | September<br>16, 2008 | September<br>19, 2008 |
| Dividend Yield:          | 0.00%                 | 0.00%                 |
| Volatility:              | 86.82%                | 91.68%                |
| Risk-free interest rate: | 1.62%                 | 2.00%                 |

Costs directly associated with the issuance of the Debentures were capitalized and amortized using the straight-line method over the term of the Debentures. As of September 30, 2008, the balance of capitalized debt issuance costs was \$209,519. Amortization charged to interest expense was \$8,399 for the nine-month period ended September 30, 2008.

## 16. CAPITAL TRANSACTION

On June 30, 2008 the Company acquired 20% ownership interest of Suo'ang New Energy with the agreed value of \$1,148,851 in exchange for the Company's issuance of 7,500,000 shares of common stock, as fully described in Note 3.

## 17. WARRANTS

The following table summarizes the Warrants outstanding and related prices for the shares of the Company's common stock issuable upon exercise of the Warrants at September 30, 2008:

| Exercise price | Number outstanding | Weighted average remaining contractual life (years) | Number exercisable | Weighted average exercise price |
|----------------|--------------------|---|--------------------|---------------------------------|
| \$0.15         | 5,337,667          | 2.96  | 1,334,416          | \$0.15                          |
| \$0.25         | 267,100            | 1.96  | 267,100            | \$0.25                          |
| \$0.15         | 3,566,667          | 2.97  | 891,666            | \$0.15                          |
| \$0.25         | 90,000             | 1.97  | 90,000             | \$0.25                          |

No warrant was exercised during the nine-month period ended September 30, 2008.



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## 18. STATUTORY RESERVES

As stipulated by the PRC's Company Law, net income after taxation can only be distributed as dividends after appropriation has been made for the following:

- a. Making up cumulative prior years' losses, if any;
- b. Allocations to the "Statutory capital reserve" of at least 10% of income after tax, as determined under PRC accounting rules and regulations, until the fund amounts to 50% of the Company's registered capital. This is restricted to set off against losses, expansion of production and operation or increase in registered capital; and
- c. Allocations of 5-10% of income after tax, as determined under PRC accounting rules and regulations, to the Company's "Statutory common welfare fund". This is restricted to capital expenditure for the collective benefits of the Company's employees; and
- d. Allocations to the discretionary surplus reserve, if approved in the shareholders' general meeting.

Statutory reserves consist of the following as of:

|                               | September 30,<br>2008 | December 31,<br>2007 |
|-------------------------------|-----------------------|----------------------|
| Statutory capital reserve     | \$ 232,206            | \$ 232,206           |
| Statutory common welfare fund | 116,103               | 116,103              |
|                               | \$ 348,309            | \$ 348,309           |

## 19. INCOME TAXES

Companies in the PRC are generally subject to PRC Enterprise Income Taxes at a statutory rate of 33% (30% of national income tax plus 3% local income tax) on the net income. However, the Company's VIE, Shaanxi Suo'ang, has been approved as a "high and new technology enterprise" and under PRC Income Tax Laws, it is entitled to a preferential tax rate of 15% upon expiry of a two years' tax holiday for 2004 and 2005, within which no income taxes were charged. Shaanxi Suoang is subject to income tax from 2006.

The Company and its wholly owned subsidiary Hangson are not subject to any income taxes as these companies had no income for the periods ended September 30, 2008 and 2007.

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The income tax expense consisted of the following as of:

|                                     | September 30, |      |
|-------------------------------------|---------------|------|
|                                     | 2008          | 2007 |
| Current – PRC Enterprise Income Tax | \$ 24,779     | \$ - |
| Deferred                            | -             | -    |
| Total income tax expenses           | \$ 24,779     | \$ - |

The following table reconciles the U.S. statutory rates to the Company's effective tax rate:

|                                       | September 30, |       |
|---------------------------------------|---------------|-------|
|                                       | 2008          | 2007  |
| U.S. statutory rate                   | 34%           | 34%   |
| Foreign income not recognized in U.S. | (34%)         | (34%) |
| Non-deductible expenses and other     | -             | -     |
| Tax holiday                           | (14%)         | -     |
| PRC preferential income tax rate      | 15%           | 15%   |
| Effective tax rate                    | 1             | 15    |
|                                       | %             | %     |

No significant deferred tax liabilities or assets existed as of either September 30, 2008 or 2007.

## 20. INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per common share for the periods ended September 30, 2008 and 2007 were determined by dividing net income for the periods by the weighted average number of common shares outstanding.

The Company has retroactively adjusted the weighted average number of common shares outstanding by deeming that the three-for-one (3:1) forward stock split on August 20, 2007 had occurred as of the beginning of the earliest period presented.

The Company did not have dilutive securities outstanding as of and during the periods ended September 30, 2008 and 2007.

## 21. RELATED PARTY TRANSACTIONS

### (a) Related party payables

Amount payable to a director as of September 30, 2008 and December 31 2007, is summarized as follows:

|                           | September 30,<br>2008 | December 31,<br>2007 |
|---------------------------|-----------------------|----------------------|
| Amount due to a director: |                       |                      |
| Mr. Peng Zhou             | \$ 1,178              | \$ 8,527             |

This balance is interest free and unsecured and has no fixed repayment date.



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(b) Disposal of patent

In 2006, the Company disposed of the patent related to the discontinued COPO resin product operations to a related company for a consideration of \$256,200. A loss on disposal of \$291,266 was recorded. The balance remains outstanding as of December 31, 2007 was \$141,795 and was repaid during the first quarter of 2008.

(c) Transfer of property

On June 13, 2006, the Company signed a property transfer agreement with a related company, HanZhong SiXiong KeChuang Commercial Company Ltd., which is controlled by a shareholder of the Company, to dispose of the Company's leasehold properties together with the leasehold improvements for an aggregate cash consideration of approximately \$2,450,000. The agreed price is \$120,000 lower than the evaluated value according to an appraisal report issued by an independent professional appraiser because the property title did not transfer from the property developer to the Company. As of December 31, 2007, \$1,567,500 was received and recorded as deposit on sale of property in the balance sheet.

On March 25, 2007 and June 21, 2007, the Company and the buyer entered into extension agreements whereby the Company extended the date for payment of the remaining balance and transfer of the title of properties to the buyer to on or before May 31, 2007 and October 31, 2007 respectively. On March 6, 2008, the Company entered a supplementary agreement whereby the Company agreed to transfer the title of the properties before May 31, 2008 and the buyer will pay the Company on or one month after the transfer of property title. The transfer of property was completed accordingly. Gain on transfer of property of \$33,095 was recorded.

(d) Forfeiture of minority interest

On June 30, 2008, the Company entered into a Securities Purchase Agreement (the "Agreement") to acquire from a minority shareholder his 20% equity ownership interest in Suo'ang New Energy as more fully described in Note 3. Pursuant to the terms of the Agreement, the minority shareholder agreed to waive any and all right he may have to any distributions and/or payments from Suo'ang New Energy beginning January 1, 2008.

22. COMMITMENTS AND CONTINGENCIES

a. Capital expenditure commitments

During the fiscal year 2007, the Company entered into various contracts for the construction of a new plant for its coal water mixture business, as well as several contracts to purchase machinery.

The Company's commitments for capital expenditure as of September 30, 2008 are as follows:

Contracted but not accrued for:

|                       |            |
|-----------------------|------------|
| Purchase of machinery | \$ 340,329 |
|-----------------------|------------|





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## b. Operating lease commitments

As of September 30, 2008, the Company's total future minimum lease payments under non-cancelable operating leases to be paid in each of the five succeeding years are as follows:

|                                   |    |        |
|-----------------------------------|----|--------|
| Periods ending September 30,      |    |        |
| 2009                              | \$ | 21,120 |
| 2010                              |    | 16,720 |
| 2011 and thereafter               |    | -      |
| Total operating lease commitments | \$ | 37,840 |

c. Social insurance of Employees

According to the prevailing laws and regulations of the PRC, the Company is required to cover its employees with medical, retirement and unemployment insurance programs. Management believes that due to the transient nature of its employees, the Company does not need to provide all employees with such social insurance.

In the event that any current or former employee files a complaint with the PRC government, the Company may be subject to making up the social insurance as well as administrative fines. As the Company believes that these fines would not be material, no provision has been made in this regard.

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Item 2. Management's Discussion and Analysis or Plan of Operation.

The following management's discussion and analysis should be read in conjunction with our consolidated financial statements and the notes thereto and the other financial information appearing elsewhere in this item. In addition to historical information, the following discussion contains certain forward-looking statements within the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements relate to our future plans, objectives, expectations and intentions. These statements may be identified by the use of words such as "may", "will", "could", "expect", "anticipate", "intend", "believe", "estimate", "plan", "predict", and similar terms or terminology, or the use of such terms or other comparable terminology. Although we believe the expectations expressed in these forward-looking statements are based on reasonable assumptions within the bound of our knowledge of our business, our actual results could differ materially from those discussed in these statements. Factors that could contribute to such differences include, but are not limited to, those discussed in the "Risk Factors" section of the Company's Annual Report on Form 10-KSB filed with the SEC on April 15, 2008. We undertake no obligation to update publicly any forward-looking statements for any reason even if new information becomes available or other events occur in the future.

Our financial statements are prepared in U.S. Dollars and in accordance with accounting principles generally accepted in the United States. See "Exchange Rates" below for information concerning the exchanges rates at which Renminbi were translated into U.S. Dollars at various pertinent dates and for pertinent periods.

In this Form 10-Q, references to "we", "our", "the", "us", the "Company", or the "Registrant" refer to Sino Clean Energy Inc., Nevada corporation, its subsidiary and affiliated entities.

Overview

Sino Clean Energy Inc. (the "Company") is engaged in the research, development, production and sale in the People's Republic of China ("China") of its "coal-water mixture" product, a fuel substitute for oil, gas or coal. Our primary business operations are conducted through our wholly-owned subsidiary Hangson Limited ("Hangson"), a British Virgin Islands company, Shaanxi Suo'ang Biological Science & Technology Co., Ltd. ("Suo'ang Biological"), a Chinese company which Hangson controls through a series of contractual arrangement, and Shaanxi Suo'ang New Energy Enterprise Company Ltd. ("Suo'ang New Energy"), a Chinese company and subsidiary of Suo'ang Biological.

Because of its contractual arrangements with Hangson, Suo'ang Biological is deemed Hangson's variable interest entity ("VIE"). Accordingly, we consolidate Suo'ang Biological's results, assets and liabilities in our financial statements. The Company's consolidated assets do not include any collateral for Suo'ang Biological's obligations. The creditors of Suo'ang Biological do not have recourse to the general credit of the Company. For a description of the contractual arrangements between Hangson and Suo'ang Biological, see the section titled "Contractual Arrangements with Shaanxi Suo'ang and its Shareholders" in the Company's Annual Report on Form 10-KSB filed with the SEC on April 15, 2008.

For the majority of fiscal 2006, Suo'ang Biological was engaged in two lines of businesses: the research, development, production, marketing and sales of coal-polymer ("COPO") resin products, and also the research, development, production and sale of coal-water mixture fuel substitute product ("CWM Fuel"). However, the Company subsequently decided to focus on its CWM Fuel business. Thus, in December 2006, Suo'ang Biological ceased operations of the COPO resin business and is now focused on its CWM Fuel business, which is conducted through Suo'ang New Energy.

The Company entered into sales contracts for the sale of the CWM Fuel in early 2007. Construction of the first phase of the Company's CWM Fuel production plant was completed in June 2007. The Company's CWM Fuel production

plant became operational and production of the CWM Fuel commenced in August 2007.

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On September 16 and 19, 2008, we issued our 18% secured convertible debentures (the “Debentures”) to certain institutional and accredited investors for an aggregate amount of \$1,335,650. The Debentures bear a fixed rate of interest at 18% per annum and mature one year from their issuance dates, provided that the principals and interests are due immediately upon an event of default. The holders of the Debentures have the right at any time to convert all or part of the outstanding principal amount of the Debentures and any accrued and unpaid interest into common shares of the Company at the then effective conversion price, initially being \$0.15 per share.

Additionally, we issued to these investors warrants to purchase up to 100% of the number of common shares that would be issuable upon conversion of the Debentures purchased by the investors. The warrants have an initial exercise price of \$0.15 per share. 25% of the common shares underlying the warrants (the “Warrant Shares”) vest and are immediately exercisable at the issuance of the warrants. Thereafter, up to 5% of the Warrant Shares shall vest and become exercisable at the end of every one-month period beginning on October 31, 2008, until the sooner of (i) the listing of the Company’s common stock on the New York Stock Exchange, the American Stock Exchange, the NASDAQ Global Select Market, the NASDAQ Global Market, or the NASDAQ Capital Market (each a “Subsequent Market”), (ii) the repayment in full of the Debentures, or (iii) until 100% of the Warrant Shares are vested. Any portion of the Warrant Shares not vested prior to the earlier of the Subsequent Market listing or repayment of the Debentures shall be deemed void. The warrants are exercisable for a period of three years from their issuance date.

### Critical Accounting Policies and Estimates

#### Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated depreciation and amortization. Gains or losses on disposals are reflected as gain or loss in the year of disposal. The cost of improvements that extend the life of plant, property and equipment are capitalized. These capitalized costs may include structural improvements, equipment and fixtures. All ordinary repair and maintenance costs are expensed as incurred.

Depreciation or amortization for financial reporting purposes is provided using the straight-line method over the estimated useful lives.

#### Goodwill

The Company accounts for acquisitions of business in accordance with SFAS No. 141 “Business Combinations”, which may result in the recognition of goodwill. Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations accounted for under the purchase method. Goodwill is not subject to amortization but will be subject to periodic evaluation for impairment. Goodwill is stated in the consolidated balance sheet at cost less accumulated impairment loss.

#### Impairment

##### (i) Long-lived Assets

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Impairment is considered to exist if the total estimated future cash flows on an undiscounted basis are less than the carrying amount of the assets, including goodwill, if any. An impairment loss is measured and recorded based on discounted estimated future cash flows. In estimating future cash flows, assets are grouped at the lowest level for which there are identifiable cash flows that are largely independent of future cash flows from other asset groups.



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(ii) Goodwill

Impairment of goodwill is tested at least annually at the reporting unit. The test consists of two steps. Firstly, the Company identifies potential impairment by comparing the fair value of the reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired. Secondly, if there is impairment identified in the first step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No 141, "Business Combinations". If the carrying value of a reporting unit exceeds its estimated fair value, the Company compares the implied fair value of the reporting unit's goodwill to its carrying amount, and any excess of the carrying value over the fair value is charged to earnings. The Company's fair value estimates are based on numerous assumptions and it is possible that actual fair value will be significantly different than the estimates.

Revenue recognition

Sales are recognized when the following four revenue criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectibility is reasonably assured. Revenues are presented net of value added tax (VAT). No return allowance is made as products are normally not returnable upon acceptance by the customers.

Foreign currency translation

The reporting currency of the Company is the United States Dollars. All assets and liabilities accounts have been translated into United States Dollars using the current exchange rate at the balance sheet date. Capital stock is recorded at historical rates. Revenue and expenses are translated using the average exchange rate in the year. The resulting gain and loss has been reported as other comprehensive income (loss) within the shareholder's equity.

Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates. Significant estimates include estimates of accruals and determination of fair values for assets disposal.

Results of Operations

Three month period ended September 30, 2008 as compared to three month period ended September 30, 2007

Revenue. During the three month period ended September 30, 2008, we had revenues from sale of our CWM Fuel of \$3,419,941, as compared to revenues of \$234,639 during the three month period ended September 30, 2007. In general, this increase is mainly attributable to sales revenue received after the Company commenced operations of its CWM Fuel production facility during the third quarter of 2007.

General and Administrative Expenses. General and administrative expenses totaled \$204,915 for the three-month period ended September 30, 2008, as compared to \$197,371 for the three-month period ended September 30, 2007. This increase was primarily caused by professional fee, salaries and traveling expenses in connection with the



commencement of our CMW Fuel operations.

Net Income. We had net income of \$1,144,737 for the three-month period ended September 30, 2008, as compared to net loss of \$148,106 for the same period in 2007. The increase in net income is primarily attributable to the commencement of our CWM Fuel operations and production during the third quarter in 2007.

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Nine month period ended September 30, 2008 as compared to six month period ended September 30, 2007

Revenue. During the nine-month period ended September 30, 2008, we had revenues from sale of our CWM Fuel of \$9,156,293, as compared to revenues of \$234,639 during the nine-month period ended September 30, 2007. In general, this increase is mainly attributable to the commencement of our CWM Fuel operation in the third quarter of 2007.

General and Administrative Expenses. General and administrative expenses totaled \$590,719 for the nine-month period ended September 30, 2008, as compared to \$330,282 for the nine-month period ended September 30, 2007. This increase was primarily caused by professional fee, salaries and traveling expenses in connection with the commencement of our CMW Fuel operations.

Net Income. We had net income of \$2,480,126 for the nine-month period ended September 30, 2008, as compared to net loss of \$124,445 for the same period in 2007. The increase in net income is primarily attributable to the commencement of our CMW Fuel operations and production in third quarter in 2007.

Liquidity and Capital Resources

Net cash flow provided from operating activities was \$154,407 for the nine months ended September 30, 2008, as compared to \$1,980,902 used in operating activities for the nine months ended September 30, 2007. The increase in our net cash flow provided by operating activities for the nine months ended September 30, 2008 was mainly due the commencement of our CWM Fuel operations in third quarter in 2007.

Net cash flow used in investing activities was \$2,791,475 for the nine months ended September 30, 2008, as compared to net cash of \$1,053,865 used in investing activities for the same period in 2007. Uses of cash flow for investing activities were mainly related to the purchase of property, plant and equipment.

Net cash flow provided by financing activities was \$2,183,606 for the nine months ended September 30, 2008, as compared to net cash flow provided by financing activities of \$74,515 for the same period in 2007. The increase in net cash flow provided by financing activities was mainly due to the issuance of our secured convertible debentures in September 2008, as well as receipt from government grant and sales proceeds from disposal of property.

We believe that we have adequate capital resources to continue our operations in the near future. We believe that our current cash balance and the revenues that will be generated will cover anticipated operating expenses for a period of at least one year without supplementing our cash reserves. We may, however, raise additional capital to further develop our products.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our investors.

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## Exchange Rates

Suo'ang Biological maintains its books and records in Renminbi ("RMB"), the lawful currency of the PRC. In general, for consolidation purposes, the Company translates Suo'ang Biological's assets and liabilities into U.S. Dollars using the applicable exchange rates prevailing at the balance sheet date, and the statement of income is translated at average exchange rates during the reporting period. Adjustments resulting from the translation of Suo'ang Biological's financial statements are recorded as accumulated other comprehensive income.

Until July 21, 2005, RMB had been pegged to US\$ at the rate of RMB8.30: US\$1.00. On July 21, 2005, the PRC government reformed the exchange rate system into a managed floating exchange rate system based on market supply and demand with reference to a basket of currencies. In addition, the exchange rate of RMB to US\$ was adjusted to RMB8.11: US\$1.00 as of July 21, 2005. The People's Bank of China announces the closing price of a foreign currency such as US\$ traded against RMB in the inter-bank foreign exchange market after the closing of the market on each working day, which will become the unified exchange rate for the trading against RMB on the following working day. The daily trading price of US\$ against RMB in the inter-bank foreign exchange market is allowed to float within a band of  $\pm 0.3\%$  around the unified exchange rate published by the People's Bank of China. This quotation of exchange rates does not imply free convertibility of RMB to other foreign currencies. All foreign exchange transactions continue to take place either through the Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the Bank of China or other institutions required submitting a payment application form together with invoices, shipping documents and signed contracts.

The exchange rates used to translate amounts in RMB into US Dollars for the purposes of preparing the consolidated financial statements or otherwise stated in this MD&A were as follows:

September 30, 2008    December 31, 2007    September 30, 2007

|  |                |                |                |
|--|----------------|----------------|----------------|
| Balance sheet items, except for the registered and paid-up capital, as of end of period/year   | USD0.1467:RMB1 | USD0.1370:RMB1 | USD0.1331:RMB1 |
| Amounts included in the statement of operations, statement of changes in stockholders' equity and statement of cash flows for the period/ year ended | USD0.1416:RMB1 | USD0.1320:RMB1 | USD0.1307:RMB1 |

No representation is made that RMB amounts have been, or would be, converted into US\$ at the above rates.

## Inflation

We believe that inflation has not had a material effect on our operations to date.

Item 3.                    Quantitative and Qualitative Disclosures About Market Risk

Not applicable

Item 4.                    Controls and Procedures

(a) Evaluation of disclosure controls and procedures. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief

Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the applicable period to ensure that the information required to be disclosed by the Company in reports that it files or submits under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

- (b) Changes in internal controls over financial reporting. There was no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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.

Reference is made to our Current Reports on Form 8-K filed with the SEC on September 17, 2008 and on September 22, 2008, respectively.

Item 3. Defaults upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Securities Holders.

None

Item 5. Other Information.

None

Item 6. Exhibits.

Exhibit

Number Description

- |      |   |
|------|---|
| 2.1  | Share Exchange Agreement between Endo Networks, Inc., Endo Majority Shareholders, Hangson Ltd. and the Hangson Shareholders dated October 18, 2006 (1)                      |
| 3.1  | Articles of Incorporation of Endo Networks, Inc., a Nevada corporation, as amended. (3)   |
| 3.2  | Bylaws of Endo Networks, Inc. (3)   |
| 3.3  | Text of Amendment to our Bylaws (4)   |
| 3.4  | Articles of Merger filed with the Secretary of State of Nevada with an effective date of August 15, 2007 (6)  |
| 10.1 | Asset and Share Purchase Agreement between Registrant and Peter B. Day (for Endo Canada) (2)  |
| 10.2 | Contract for Technology Transfer between Shaanxi Suo'ang Biological Science & Technology Co., Ltd. and HanZhongWeiDa Commercial Company Limited dated December 25, 2006 (5) |
| 10.3 | Machineries Transfer Agreement between Shaanxi Suo'ang Biological Science & Technology Co., Ltd. and HanZhongWeiDa Commercial Company Limited dated January 10, 2007 (5)    |

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- 10.4 Securities Purchase Agreement dated as of June 30, 2008, by and among Mr. Peng Zhou, Sino Clean Energy Inc., Hangson Limited and Shaanxi Suo'ang New Energy Enterprise Co., Ltd. (8)
- 31.1 Section 302 Certification by the Corporation's Chief Executive Officer \*
- 31.2 Section 302 Certification by the Corporation's Chief Financial Officer \*
- 32.1 Section 906 Certification by the Corporation's Chief Executive Officer \*
- 32.2 Section 906 Certification by the Corporation's Chief Financial Officer \*
- 99.1 Consulting Services Agreement by and between Hangson Limited and Shaanxi Suo'ang Biological Science & Technology Co., Ltd. dated August 18, 2006 (3)

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- 99.4 Proxy Agreement by and between Hangson Limited and Shaanxi Suo'ang Biological Science & Technology Co., Ltd. ("Shaanxi Suoang") and Shaanxi Suoang's Majority Shareholders dated August 18, 2006 (3)
- 99.5 Option Agreement between Hangson Limited and Shaanxi Suo'ang Biological Science & Technology Co., Ltd. ("Shaanxi Suoang") and Shaanxi Suoang's Majority Shareholders dated August 18, 2006 (3)
- 99.6 Agreement by and between Shaanxi Suo'ang Biological Science and Technology Co. Ltd. and Hanzhong Si Xiong Ke Chuang Business Co. Ltd. (3)
- 99.7 Supplementary Agreement by and between Shaanxi Suo'ang Biological Science and Technology Co. Ltd. and Hanzhong Si Xiong Ke Chuang Business Co. Ltd. dated March 25, 2007 (5)
- 99.8 Agreement to Defer Payment for Property Transfer by and between Shaanxi Suo'ang Biological Science and Technology Co. Ltd. and Hanzhong Si Xiong Ke Chuang Business Co. Ltd. dated June 21, 2007 (7)
- 99.9 Supplementary Agreement to the Property Transfer Agreement by and between Shaanxi Suo'ang Biological Science and Technology Co. Ltd. and Hanzhong Si Xiong Ke Chuang Business Co. Ltd. dated March 6, 2008 (7)

\* Filed herewith

- (1) Filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on October 18, 2006 and incorporated herein by reference.
- (2) Filed as Exhibit A of Registrant's Schedule 14A filed with the SEC on August 8, 2006 and incorporated herein by reference.
- (3) Filed as Exhibits to the Registrant's Current Report on Form 8-K filed with the SEC on October 26, 2006 and incorporated herein by reference.
- (4) Filed as an Exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on November 17, 2006 and incorporated herein by reference.
- (5) Filed as Exhibits to the Registrant's Annual Report on Form 10-KSB filed with the SEC on May 3, 2007 and incorporated herein by reference.
- (6) Filed as an Exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on August 17, 2007 and incorporated herein by reference.
- (7) Filed as an Exhibit to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 19, 2008 and incorporated herein by reference.
- (8) Filed as an Exhibit to the Registrant's Current Report on Form 8-K filed with the SEC on July 7, 2008 and incorporated herein by reference.

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SIGNATURES

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

SINO CLEAN ENERGY INC.  
(Registrant)

Date: November 13, 2008

By: /s/ Baowen Ren  
Baowen Ren  
Chief Executive Officer