

SINOCOKING COAL & COKE CHEMICAL INDUSTRIES, INC.

Form 10-Q

November 14, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

**FORM 10-Q**

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

For the quarterly period ended **September 30, 2014**

or

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

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

Commission File Number: **001-15931**

**SinoCoking Coal and Coke Chemical Industries, Inc.**

(Exact name of registrant as specified in its charter)

**Florida**

(State or other jurisdiction of incorporation or

organization)

**98-0695811**

(I.R.S. Employer Identification Number)

**Kuanggong Road and Tiyu Road 10th Floor**

**Chengshi Xin Yong She, Tiyu Road, Xinhua District**

**Pingdingshan, Henan Province**

**People's Republic of China**

**467000**

(Address of principal executive offices)

(Zip Code)

**+86-3752882999**

(Registrant's telephone number, including area code)

**N/A**

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every, Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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

As of November 12, 2014, the registrant had 23,960,217 shares of common stock outstanding.

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## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*All statements contained in this report, 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,” “project,” “may,” “might,” “will,” the negative forms thereof, 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. Forward-looking statements by their nature involve substantial risks and uncertainties, certain of which are beyond our control. Actual results, performance or achievements may differ materially from those expressed or implied by forward-looking statements depending on a variety of important factors, including, but not limited to, weather, local, regional, national and global coke and coal price fluctuations, levels of coal and coke production in the region, the demand for raw materials such as iron and steel which require coke to produce, availability of financing and interest rates, competition, changes in, or failure to comply with, government regulations, costs, uncertainties and other effects of legal and other administrative proceedings, and other risks and uncertainties. Such risks and uncertainties are described in greater details in the “Risk Factors” section beginning on page 22 of the registrant’s annual report on Form 10-K for the year ended June 30, 2013 filed with the Securities and Exchange Commission (the “SEC”) on September 30, 2013 (the “Annual Report”).*

*Consequently, all of the forward-looking statements made in this report 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 the registrant’s business operations. The registrant is not undertaking to update or revise any forward-looking statement, whether as a result of new information, future events or circumstances or otherwise.*

**PART I – FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)**

## SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

|                                | September 30,<br>2014<br>(Unaudited) | June 30,<br>2014 |
|--------------------------------|--------------------------------------|------------------|
| <b>ASSETS</b>                  |                                      |                  |
| <b>CURRENT ASSETS</b>          |                                      |                  |
| Cash                           | \$ 11,580,213                        | \$ 191,992       |
| Accounts receivable, trade     | 11,445,037                           | 8,946,435        |
| Other receivables and deposits | 5,889,836                            | 5,787,232        |
| Loans receivable               | 3,532,037                            | 8,032,037        |
| Inventories                    | 4,193,118                            | 7,419,821        |
| Advances to suppliers          | 8,437,466                            | 8,700,022        |
| Prepaid expenses               | 91,667                               | -                |
| Total current assets           | 45,169,374                           | 39,077,539       |
| PLANT AND EQUIPMENT, net       | 14,148,219                           | 14,426,319       |
| CONSTRUCTION IN PROGRESS       | 47,425,916                           | 40,389,961       |
| <b>OTHER ASSETS</b>            |                                      |                  |
| Refundable deposit             | 4,874,324                            | 4,873,928        |
| Prepayments                    | 61,820,654                           | 61,815,632       |
| Intangible assets, net         | 32,290,633                           | 32,305,697       |
| Long-term investments          | 2,898,469                            | 2,898,233        |
| Other assets                   | 113,734                              | 113,725          |
| Total other assets             | 101,997,814                          | 102,007,215      |
| Total assets                   | \$ 208,741,323                       | \$ 195,901,034   |
| <b>LIABILITIES AND EQUITY</b>  |                                      |                  |
| <b>CURRENT LIABILITIES</b>     |                                      |                  |

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|   |               |               |
|---|---------------|---------------|
| Current maturity of long term loan  | \$20,797,114  | \$20,795,425  |
| Accounts payable, trade   | 673,449       | 2,978,326     |
| Other payables and accrued liabilities  | 1,882,845     | 2,460,113     |
| Other payables - related party  | 2,544,833     | 526,699       |
| Acquisition payable   | 4,711,846     | 4,711,463     |
| Customer deposits   | 79,707        | 79,701        |
| Taxes payable   | 1,691,858     | 765,421       |
| Current portion of warrants liability   | 3,994,869     | -             |
| Total current liabilities   | 36,376,521    | 32,317,148    |
| <b>LONG TERM LIABILITIES</b>  |               |               |
| Long term loan  | 29,245,942    | 29,243,566    |
| Warrants liability  | 8,080,425     | 16            |
| Total long term liabilities   | 37,326,367    | 29,243,582    |
| Total liabilities   | 73,702,888    | 61,560,730    |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |               |               |
| <b>EQUITY</b>   |               |               |
| Common stock, \$0.001 par value, 100,000,000 shares authorized, 23,960,217 shares and 21,121,372 shares issued and outstanding as of September 30, 2014 and June 30, 2014, respectively | 23,960        | 21,121        |
| Additional paid-in capital  | 6,845,636     | 3,592,053     |
| Statutory reserves  | 3,689,941     | 3,689,941     |
| Retained earnings   | 109,742,150   | 112,295,407   |
| Accumulated other comprehensive income  | 10,405,148    | 10,410,182    |
| Total SinoCoking Coal and Coke Chemicals Industries, Inc's equity   | 130,706,835   | 130,008,704   |
| NONCONTROLLING INTERESTS  | 4,331,600     | 4,331,600     |
| Total equity  | 135,038,435   | 134,340,304   |
| Total liabilities and equity  | \$208,741,323 | \$195,901,034 |

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

## SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(UNAUDITED)

|  | For the Three Months Ended September 30, |               |
|--|--|---------------|
|  | 2014                                     | 2013          |
| REVENUE                                  | \$ 13,573,836                            | \$ 17,475,970 |
| COST OF REVENUE                          | 11,292,494                               | 14,378,669    |
| GROSS PROFIT                             | 2,281,342                                | 3,097,301     |
| OPERATING EXPENSES:                      |  |               |
| Selling                                  | 34,164                                   | 40,874        |
| General and administrative               | 887,795                                  | 603,581       |
| Total operating expenses                 | 921,959                                  | 644,455       |
| INCOME FROM OPERATIONS                   | 1,359,383                                | 2,452,846     |
| OTHER INCOME (EXPENSE)                   |  |               |
| Interest income                          | 102,251                                  | 183,093       |
| Interest expense                         | (1,497,213)                              | (778,767)     |
| Other finance expense                    | (663)                                    | (62,543)      |
| Change in fair value of warrants         | (2,027,162)                              | 12            |
| Total other expense, net                 | (3,422,787)                              | (658,205)     |
| INCOME (LOSS) BEFORE INCOME TAXES        | (2,063,404)                              | 1,794,641     |
| PROVISION FOR INCOME TAXES               | 489,853                                  | 633,757       |
| NET INCOME (LOSS)                        | (2,553,257)                              | 1,160,884     |
| OTHER COMPREHENSIVE INCOME (LOSS)        |  |               |
| Foreign currency translation adjustment  | (5,034)                                  | 845,447       |
| COMPREHENSIVE INCOME (LOSS)              | \$ (2,558,291)                           | \$ 2,006,331  |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES |  |               |
| Basic and diluted                        | 21,310,527                               | 21,121,372    |
| EARNINGS (LOSSES) PER SHARE              |  |               |

Basic and diluted \$ (0.12 ) \$ 0.05

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



## SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

|  | For the Three Months Ended September |                |
|--|--------------------------------------|----------------|
|  | 30,                                  |                |
|  | 2014                                 | 2013           |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                                      |                |
| Net income (loss)  | \$ (2,553,257                        | ) \$ 1,160,884 |
| Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities: |                                      |                |
| Depreciation   | 279,032                              | 280,236        |
| Amortization and depletion   | 17,674                               | 17,659         |
| Write-off of other receivables and advances to suppliers                                       | -                                    | 85,938         |
| Change in fair value of warrants   | 2,027,162                            | (12            |
| Bad debt expense   | 116,359                              | -              |
| Amortization of prepaid expense  | 8,333                                | -              |
| Change in operating assets and liabilities   |                                      |                |
| Accounts receivable, trade   | (2,641,476                           | ) 253,487      |
| Other receivables  | (72,829                              | ) (1,333,864   |
| Inventories  | 3,224,546                            | 753,639        |
| Advances to suppliers  | 263,038                              | (601,098       |
| Prepaid expenses   | -                                    | (269,658       |
| Accounts payable, trade  | (2,303,148                           | ) 194,299      |
| Other payables and accrued liabilities   | (675,686                             | ) (1,096,598   |
| Customer deposits  | -                                    | (81,100        |
| Taxes payable  | 925,584                              | 70,384         |
| Net cash used in operating activities  | (1,384,668                           | ) (565,804     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                      |                |
| Collection of loan receivable  | 4,500,000                            | -              |
| Payments of construction in progress and equipment   | (7,026,661                           | ) -            |
| Net cash used in investing activities  | (2,526,661                           | ) -            |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                                      |                |
| Change in restricted cash  | -                                    | 9,732,000      |
| Payments of note payable   | -                                    | (9,732,000     |
| Proceeds from issuance of common shares  | 13,204,538                           | -              |
| Proceeds from due to related party   | 2,016,383                            | -              |
| Net cash provided by financing activities  | 15,220,921                           | -              |
| <b>EFFECT OF EXCHANGE RATE ON CASH</b>   | <b>78,629</b>                        | <b>72,831</b>  |

|  |               |              |   |
|--|---------------|--------------|---|
| INCREASE (DECREASE) IN CASH  | 11,388,221    | (492,973     | ) |
| CASH, beginning of period  | 191,992       | 782,018      |   |
| CASH, end of period  | \$ 11,580,213 | \$ 289,045   |   |
| SUPPLEMENTAL CASH FLOW INFORMATION:  |               |              |   |
| Cash paid for income tax   | \$ 336,180    | \$ 222,990   |   |
| Cash paid for interest expense   | \$ 2,123,933  | \$ 1,900,455 |   |
| NON-CASH TRANSACTIONS OF INVESTING AND FINANCING ACTIVITIES                              |               |              |   |
| Recalsification of salary payable to related parties to other payable to related parties | \$ -          | \$ 236,890   |   |
| Stock based compensation prepaid to a service provider                                   | \$ 100,000    | \$ -         |   |
| Issuance of warrants related to the sale of common stock                                 | \$ 10,048,116 | \$ -         |   |

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

**Note 1 – Nature of business and organization**

SinoCoking Coal and Coke Chemical Industries, Inc. (“SinoCoking” or the “Company”) was organized on September 30, 1996, under the laws of the State of Florida.

The Company is a vertically-integrated coal and coke producer based in the People’s Republic of China (“PRC” or “China”). All of the Company’s business operations are conducted by a variable interest entity (“VIE”), Henan Pingdingshan Hongli Coal & Coking Co., Ltd., (“Hongli”), which is controlled by Top Favour’s wholly-owned subsidiary, Pingdingshan Hongyuan Energy Science and Technology Development Co., Ltd. (“Hongyuan”), through a series of contractual arrangements.

Due to the continuing provincial-wide consolidation program in Henan, all small to mid-scale mines are required to be consolidated and undergo mandatory safety checks and inspections by relevant authorities before receiving clearance to resume coal mining operations. This requirement applies to all SinoCoking mines. The Company is in the processing of seeking other ways to restructure or resume the coal mine operations.

The accompanying consolidated financial statements reflect the activities of the Company and each of the following entities:

| Name       | Background  | Ownership                       |
|------------|---|---------------------------------|
| Top Favour | <ul style="list-style-type: none"> <li>· A British Virgin Islands company</li> <li>· Incorporated on July 2, 2008</li> </ul>  | 100%                            |
| Hongyuan   | <ul style="list-style-type: none"> <li>· A PRC limited liability company and deemed a wholly foreign owned enterprise (“WFOE”)</li> <li>· Incorporated on March 18, 2009</li> <li>· Registered capital of \$3 million fully funded</li> </ul> | 100%                            |
| Hongli     | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on June 5, 1996</li> </ul>   | VIE by contractual arrangements |

|   |  |  |
|---|--|--|
|   | <ul style="list-style-type: none"> <li>· Initial registered capital of \$1,055,248 or 8,808,000 Renminbi (“RMB”), further increased to \$4,001,248 (RMB 28,080,000) on August 26, 2010, fully funded</li> <li>· 85.40% of equity interests held by Jianhua Lv, the Company’s Chief Executive Officer (“CEO”) and Chairman of the Board of Directors</li> <li>· Operates a branch, Baofeng Coking Factory (“Baofeng Coking”)</li> </ul> |  |
| Baofeng Hongchang Coal Co., Ltd. (“Hongchang Coal”)   | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on July 19, 2007</li> <li>· Registered capital of \$396,000 (RMB 3,000,000) fully funded</li> </ul>   | VIE by contractual arrangements as a wholly-owned subsidiary of Hongli           |
| Baofeng Shunli Coal Co., Ltd. (“Shunli Coal”)         | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on August 13, 2009</li> <li>· Registered capital of \$461,700 (RMB3,000,000) fully funded</li> <li>· Acquired by Hongchang Coal on May 20, 2011</li> <li>· Dissolved on July 4, 2012 and the mining right transferred to Hongchang.</li> </ul>  | VIE by contractual arrangements as an indirect wholly-owned subsidiary of Hongli |
| Baofeng Hongguang Power Co., Ltd. (“Hongguang Power”) | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on August 1, 2006</li> <li>· Registered capital of \$2,756,600 (RMB 22,000,000) fully funded</li> </ul>   | VIE by contractual arrangements as a wholly-owned subsidiary of Hongli           |

SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, INC AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

|   |   |  |
|---|---|--|
| Baofeng Xingsheng Coal Co., Ltd. (“Xingsheng Coal”) | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on December 6, 2007</li> <li>· Registered capital of \$559,400 (RMB 3,634,600) fully funded</li> <li>· 60% of equity ownership acquired by Hongli on May 20, 2011</li> </ul>   | <p>VIE by contractual arrangements as a 60% owned subsidiary of Hongli</p>     |
| Baofeng Shuangrui Coal Co., Ltd. (“Shuangrui Coal”) | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on March 17, 2009</li> <li>· Registered capital of \$620,200 (RMB4,029,960) fully funded</li> <li>· 60% of equity ownership acquired by Hongli on May 20, 2011</li> <li>· 100% of equity ownership acquired by Hongchang on June 20, 2012</li> </ul> | <p>VIE by contractual arrangements as a 100% owned subsidiary of Hongchang</p> |
| Zhonghong Energy Investment Company (“Zhonghong”)   | <ul style="list-style-type: none"> <li>· A PRC company</li> <li>· Incorporated on December 30, 2010</li> <li>· Registered capital of \$7,842,800 (RMB51,000,000) fully funded equity interests of 100% held by three nominees on behalf of Hongli pursuant to share entrustment agreements</li> </ul>   | <p>VIE by contractual arrangements as a wholly-owned subsidiary of Hongli</p>  |
| Baofeng Hongrun Coal Chemical Co., Ltd. (“Hongrun”) | <ul style="list-style-type: none"> <li>· A PRC limited liability company</li> <li>· Incorporated on May 17, 2011</li> <li>· Registered capital of \$ 4,620,000 (RMB30 million) fully funded</li> </ul>  | <p>VIE by contractual arrangements as a wholly-owned subsidiary of Hongli</p>  |

The Company believes that the equity owners of Hongli do not have the characteristics of a controlling financial interest, and that the Company is the primary beneficiary of the operations and residual returns of Hongli and, in the event of losses, would be required to absorb a majority of such losses. Accordingly, the Company consolidates Hongli's results, assets and liabilities in the accompanying financial statements.

Selected financial data of Hongli and its subsidiaries is set forth below:

|                           | September 30,<br>2014 | June 30,<br>2014 |
|---------------------------|-----------------------|------------------|
| Total current assets      | \$20,030,896          | \$21,003,224     |
| Total assets              | \$180,353,296         | \$174,577,433    |
| Total current liabilities | \$56,426,011          | \$50,305,119     |
| Total liabilities         | \$85,671,953          | \$79,548,685     |

Presently, the Company's coking related operations are carried out by Baofeng Coking, coal related operations by Hongchang Coal, Shuangrui Coal and Xingsheng Coal, and electricity generation by Hongguang Power. However, it is the Company's intention to transfer all coal related operations to a joint-venture between Zhonghong and Henan Province Coal Seam Gas Development and Utilization Co., Ltd. ("Henan Coal Seam Gas") (see Note 12). As of September 30, 2014, the Company's coal related operations had not been transferred to the joint-venture, and Shuangrui Coal and Xingsheng Coal had had no operations since their acquisitions by the Company (see Note 20).

SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, INC AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**Note 2 – Summary of significant accounting policies**

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to make the financial statements not misleading have been included. Operating results for the three months periods ended September 30, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2015. The information included in this Form 10-Q should be read in conjunction with the “Management’s Discussion and Analysis” section, and the financial statements and notes thereto, included in the Annual Report.

Principles of consolidation

The accompanying unaudited condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The unaudited condensed consolidated financial statements include the financial statements of the Company, its wholly-owned subsidiaries – Top Favour and Hongyuan, and its VIEs – Hongli and its subsidiaries. All significant inter-company transactions and balances between the Company, its subsidiaries and VIEs are eliminated upon consolidation.

VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision making ability. All VIEs with which the Company is involved are evaluated to determine the primary beneficiary of the risks and rewards of the VIE. The primary beneficiary is required to consolidate the VIE for financial reporting purposes. As a result of the contractual arrangements described below, the Company, through Hongyuan, is obligated to absorb a majority of the risk of loss from Hongli’s activities and the Company is enabled to receive a majority of Hongli’s expected residual returns. The Company accounts for Hongli as a VIE and is the primary beneficiary. The primary beneficiary is required to consolidate the VIE for financial reporting purposes. Management makes ongoing assessments of whether Hongyuan is the primary beneficiary of Hongli and its subsidiaries.

Accounting Standards Codification (“ASC”) 810 – “Consolidation” addresses whether certain types of entities referred to as VIEs, should be consolidated in a company’s consolidated financial statements. The contractual arrangements entered into between Hongyuan and Hongli are comprised of the following series of agreements:



SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, INC AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

a Consulting Services Agreement, through which Hongyuan has the right to advise, consult, manage and operate  
(1) Hongli and its subsidiaries (“the Operating Companies”), collect, and own all of the respective net profits of the Operating Companies;

an Operating Agreement, through which Hongyuan has the right to recommend director candidates and appoint the senior executives of the Operating Companies, approve any transactions that may materially affect the assets,  
(2) liabilities, rights or operations of the Operating Companies, and guarantee the contractual performance by the Operating Companies of any agreements with third parties, in exchange for a pledge by the Operating Companies of their respective accounts receivable and assets;

a Proxy Agreement, under which the equity holders of the Operating Companies have vested their voting control  
(3) over the Operating Companies to Hongyuan and will only transfer their equity interests in the Operating Companies to Hongyuan or its designee(s);

an Option Agreement, under which the equity holders of the Operating Companies have granted Hongyuan the  
(4) irrevocable right and option to acquire all of its equity interests in the Operating Companies, or, alternatively, all of the assets of the Operating Companies; and

an Equity Pledge Agreement, under which the equity holders of the Operating Companies have pledged all of their  
(5) rights, title and interest in the Operating Companies to Hongyuan to guarantee the Operating Companies’ performance of their respective obligations under the Consulting Services Agreement.

Use of estimates

The preparation of the unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The more significant areas requiring the use of management estimates and assumptions relate to coal reserves that are the basis for future cash flow estimates and units-of-production depletion calculations; asset impairments; allowance for doubtful accounts and loans receivable; valuation allowances for deferred income taxes; reserves for contingencies; stock-based compensation and the fair value and accounting treatment for warrants. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Accordingly, actual results may differ significantly from these estimates.

Stock-based compensation

The Company records share-based compensation expense based upon the grant date fair value of share-based awards. The value of the award is principally recognized as expense ratably over the requisite service periods. The Company uses the Black-Scholes Merton (“BSM”) option-pricing model, which incorporates various assumptions including volatility, expected life and interest rates to determine fair value. The Company’s expected volatility assumption is based on the historical volatility of Company’s stock. The expected life assumption is primarily based on the simplified method of the terms of the options. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Stock-based compensation expense is recognized based on awards expected to vest. U.S. GAAP require forfeitures to be estimated at the time of grant and revised in subsequent periods, if necessary, when actual forfeitures differ from those estimates. There were no estimated forfeitures as the Company has a short history of issuing options.

Revenue recognition

Coal and coke sales are recognized at the date of shipment to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectability is reasonably assured. This generally occurs when coal and coke is loaded onto trains or trucks at one of the Company’s loading facilities or at third party facilities.

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Substantially, if not all, of the electricity generated by Hongguang Power is typically used internally by Baofeng Coking. Supply of surplus electricity generated by Hongguang Power to the national power grid is mandated by the local utilities board. The value of the surplus electricity supplied, if it exists, is calculated based on actual kilowatt-hours produced and transmitted and at a fixed rate determined under contract. During the three months ended September 30, 2014 and 2013, the Company did not sell surplus electricity to the national power grid.

Coal and coke sales represent the invoiced value of goods, net of a value-added tax (“VAT”), sales discounts and actual returns at the time when product is sold to the customer.

Foreign currency translation and other comprehensive income

The reporting currency of the Company is the U.S. dollar. The functional currency of the Company, its subsidiaries and VIEs in the PRC is denominated in RMB.

For the subsidiaries and VIEs whose functional currencies are other than the U.S. dollar, all assets and liabilities accounts were translated at the exchange rate on the balance sheet date; shareholders’ equity is translated at the historical rates and items in the statement of operations are translated at the average rate for the period. Items in the cash flow statement are also translated at average translation rates for the periods, therefore, amounts reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet. Translation adjustments resulting from this process are included in accumulated other comprehensive income in the statement of equity. The resulting transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations.

The balance sheet amounts, with the exception of equity, at September 30, 2014 and June 30, 2014 were translated at RMB 6.15 to \$1 and RMB 6.16 to \$1, respectively. The average translation rates applied to income and cash flow statement amounts were at RMB 6.16 to \$1 and RMB 6.17 to \$1 for the three months ended September 30, 2014 and 2013, respectively.

Fair value of financial instruments

The Company uses a three-level valuation hierarchy for disclosures of fair value measurement. The carrying amounts reported in the accompanying consolidated balance sheets for receivables, payables and short term loans qualify as financial instruments are a reasonable estimate of fair value because of the short period of time between the origination of such instruments, their expected realization and, if applicable, the stated rate of interest is equivalent to rates currently available. The three levels of valuation hierarchy are defined as follows:

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

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

Level 3 Inputs to the valuation methodology are unobservable.

The Company determined that the carrying value of its long-term loans approximated their fair value using level 2 inputs by comparing the stated loan interest rate to the rate charged by the Bairui Trust on similar loans (see Note 13).

The following table sets forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2014:

|                    | Carrying value at<br>September 30, 2014 | Fair value measurement at<br>September 30, 2014 |               |         |
|--------------------|---|---|---------------|---------|
|                    |   | Level<br>1                                      | Level 2       | Level 3 |
| Warrants liability | \$ 12,075,294                           | \$ -  | \$ 12,075,294 | \$ -    |

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The following is a reconciliation of the beginning and ending balances of warrants liability measured at fair value on a recurring basis using observable inputs as of September 30, 2014 and June 30, 2014:

|                                    | September 30,<br>2014 | June 30,<br>2014 |
|------------------------------------|-----------------------|------------------|
| Beginning fair value               | \$ 16                 | \$ 21            |
| Realized loss recorded in earnings | 2,027,162             | (5 )             |
| Granted financial instrument       | 10,048,116            |                  |
| Ending fair value                  | \$ 12,075,294         | \$ 16            |

|                              | September 30,<br>2014 | June 30,<br>2014 |
|------------------------------|-----------------------|------------------|
| Number of shares exercisable | 5,550,969             | 3,906,853        |
| Range of exercise price      | \$ 6.00-48.00         | \$6.00-48.00     |
| Stock price                  | \$ 3.79               | \$1.22           |
| Expected term (years)        | 0.35-3.99             | 0.60-2.78        |
| Risk-free interest rate      | 0.02-1.71 %           | 0.15-0.91 %      |
| Expected volatility          | 83-199 %              | 49-61 %          |

In addition to assets and liabilities that are recorded at fair value on a recurring basis, the Company is required to record certain financial assets and liabilities at fair value on a non-recurring basis. Generally, assets are recorded at fair value on a non-recurring basis as a result of impairment charges. For the three months ended September 30, 2014 and 2013, the Company's two long term investments are not considered impaired.

The Company did not identify any other assets and liabilities that are required to be presented on the consolidated balance sheets at fair value.

### Cash

The Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents for cash flow statement purposes. Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the PRC and with banks in Hong Kong and in the United States.

Balances at financial institutions or state owned banks within the PRC are not covered by insurance. Balances at financial institutions in Hong Kong may, from time to time, exceed Hong Kong Deposit Protection Board's insured limits. As of September 30, 2014 and June 30, 2014, the Company had \$11,001,934 and \$73,389 of cash deposits, which were not covered by insurance, respectively. The Company has not experienced any losses in such accounts.

Accounts receivables, trade, net

During the normal course of business, the Company extends unsecured credit not exceeding three months to its customers. Management regularly reviews aging of receivables and changes in payment trends by its customers, and records an allowance when management believes collection of amounts due are at risk. Accounts receivables are considered past due after three months from the date credit was granted. Accounts considered uncollectible after exhaustive efforts to collect are written off. The Company regularly reviews the credit worthiness of its customers and, based on the results of the credit review, determines whether extended payment terms can be granted to or, in some cases, partial prepayment is required from certain customers. As of September 30, 2014 and June 30, 2014, \$286,030 and \$140,158 allowance for doubtful accounts was provided, respectively.

Other receivables and deposit

Other receivables include security deposit made for auction of purchasing non-performing assets, interest receivable on loans, advances to employees for general business purposes and other short term non-traded receivables from unrelated parties, primarily as unsecured demand loans, with no stated interest rate or due date. Management regularly reviews aging of receivables and changes in payment trends and records a reserve when management believes collection of amounts due are at risk. Accounts considered uncollectible are written off after exhaustive efforts at collection. As of September 30, 2014 and June 30, 2014, \$0 and \$29,396 allowance for doubtful accounts was provided, respectively.

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Loans receivable

Loans receivable represents the amount the Company expects to collect from unrelated parties. The loans either are due on demand or mature within a year, and are either unsecured or secured by the properties of the borrowers or guaranteed by unrelated parties. All loans receivables are subject to interest charges. No allowance for doubtful accounts is considered necessary at the balance sheet dates.

Inventories

Inventories are stated at the lower of cost or market, using the weighted average cost method. Inventories consist of raw materials, supplies, work in process, and finished goods. Raw materials mainly consist of coal (mined and purchased), rail, steel, wood and additives used by the Company. The cost of finished goods includes (1) direct costs of raw materials, (2) direct labor, (3) indirect production costs, such as allocable utilities cost, and (4) indirect labor related to the production activities, such as assembling and packaging. Management compares the cost of inventories with the market value and an allowance is made for writing down the inventory to its market value, if lower than cost. On an ongoing basis, inventories are reviewed for potential write-down for estimated obsolescence or unmarketable inventories equal to the difference between the costs of inventories and the estimated net realizable value based upon forecasts for future demand and market conditions. When inventories are written-down to the lower of cost or market, they are not marked up subsequently based on changes in underlying facts and circumstances. As of September 30, 2014 and June 30, 2014, amount to \$169,578 and \$169,565 was provided for doubtful inventories impairment.

Advances to suppliers

The Company advances monies or may legally assign its notes receivable-trade (which are guaranteed by banks) to certain suppliers for raw material purchases. Such advances are interest-free and unsecured. Management regularly reviews aging of advances to suppliers and changes in materials receiving trends and records an allowance when management believes collection of materials due are at risk. Advances aged over one year and considered uncollectible are written off after exhaustive efforts at collection. No allowance for doubtful accounts is considered necessary at the balance sheet dates.

Plant and equipment, net

Plant and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred, while additions, renewals and betterments that extend the useful life are capitalized. When items of plant and equipment are retired or otherwise disposed, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Mine development costs are capitalized and amortized by the units of production method over estimated total recoverable proven and probable reserves. Depreciation of plant and equipment is provided using the straight-line method for substantially all assets with estimated lives as follows:

|                          | Estimated useful life |
|--------------------------|-----------------------|
| Building and plant       | 20 years              |
| Machinery and equipment  | 10-20 years           |
| Other equipment          | 1-5 years             |
| Transportation equipment | 5-7 years             |

Construction-in-progress (“CIP”) includes direct costs of construction for mining tunnel improvements and the Company’s new coking plant. Interest incurred during the period of construction, if material, is capitalized. For the three months ended September 30, 2014 and 2013, no interests were capitalized into CIP for construction is halted during the period. All other interest is expensed as incurred. CIP is not depreciated until such time the asset in question is completed and put into service.

#### Refundable deposit

A deposit was made to Henan Coal Seam Gas and is refundable when its joint venture with Zhonghong commences operations (see Note 12).



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Intangible assets

Costs to obtain land use rights are recorded based on the fair value at acquisition and amortized over 36 years, the contractual period of the rights. Intangible assets with finite lives are amortized over their useful lives and reviewed at least annually for impairment.

Mining rights are capitalized at fair value when acquired, including amounts associated with any value beyond proven and probable reserves, and amortized to operations as depletion expense using the units-of-production method over the estimated proven and probable recoverable amounts. The Company's coal reserves are controlled through its VIEs, which control generally lasts until the recoverable reserves are depleted.

Impairment of long - lived assets

The Company evaluates long-lived tangible and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows, in accordance with the accounting guidance regarding "Disposal of Long-Lived Assets." Recoverability is measured by comparing an asset's carrying value to the related projected undiscounted cash flows generated by the long-lived asset or asset group, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. When the carrying value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third party independent appraisals, as considered necessary.

Long-term investment

Investments in equity securities of privately-held companies in which the Company holds less than 20% voting interest and to which the Company does not have the ability to exercise significant influence are accounted for under the cost method.

Entities in which the Company has the ability to exercise significant influence, but does not have a controlling interest, are accounted for under the equity method. Significant influence is generally considered to exist when the Company has between 20% and 50% of ownership interest in the voting share, but other factors, such as representation on the board of directors, voting rights and the impact of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate.

The Company evaluates potential impairment whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable. For investments carried at cost, the Company recognizes impairment in the event that the carrying value of the investment exceeds the Company's proportionate share of the net book value of the investee. Management believes that no impairment charge was necessary as of September 30, 2014 and June 30, 2014.

#### Asset retirement cost and obligations

The Company accounts for the asset retirement cost and obligations to retire tangible long-lived assets in accordance with U.S. GAAP, which requires that the Company's legal obligations associated with the retirement of long-lived assets be recognized at fair value at the time the obligations are incurred. Such obligations are incurred when development commences for underground mines or construction begins for support facilities, refuse areas and slurry ponds. If an entity has a conditional asset retirement obligation, a liability should be recognized when the fair value of the obligations can be reasonably estimated.

The obligation's fair value is determined using discounted cash flow techniques and is accreted over time to its expected settlement value. Upon initial recognition of a liability, a corresponding amount is capitalized as part of the carrying amount of the related long-lived asset. Amortization of the related asset is calculated on a unit-of-production method by amortizing the total estimated cost over the salable reserves as determined under SEC Industry Guide 7, multiplied by the production during the period.

Asset retirement costs generally include the cost of reclamation (the process of bringing the land back to its natural state after completion of exploration activities) and environmental remediation (the physical activity of taking steps to remediate, or remedy, any environmental damage caused).

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In May 2009, the Henan Bureau of Finance and the Bureau of Land and Resource issued regulations requiring mining companies to file an evaluation report regarding the environmental impacts of their mining (the "Evaluation Report") before December 31, 2010. The relevant authorities would then determine whether to approve the Evaluation Report after performing on-site investigation, and the asset retirement obligation would be determined by the authorities based on the approved filing. Such requirement was extended along with the extension of the provincial mine consolidation schedule, although the specific extension date has not been finalized by the relevant provincial authorities.

The Company did not record any asset retirement obligation as of September 30, 2014 and June 30, 2014 because the Company did not have sufficient information to reasonably estimate the fair value of such obligation. The range of time over which the Company may settle the obligation is unknown and cannot be reasonably estimated. In addition, the settlement method for the obligation cannot be reasonably determined. The amount of the obligation to be determined by the relevant authorities is affected by several factors, such as the extent of remediation required in and around the mining area, the methods to be used to remediate the mining site, and any government grants which may or may not be credited to the mining companies.

The Company will recognize the liability in the period in which sufficient information is available to reasonably estimate its fair value.

Income taxes

Deferred income taxes are provided on the asset and liability method for temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of assessable tax profit. In principle, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probably that taxable profit will be available against which deductible temporary differences can be utilized. Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled. Deferred tax is charged or credited in the income statement, except when it related to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity.

An uncertain tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting

the “more likely than not” test, no tax benefit is recorded. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the period incurred. No significant penalties or interest relating to income taxes were incurred during the three months ended September 30, 2014, and 2013.

#### Chinese income taxes

The Company’s subsidiary and VIEs that operate in the PRC are governed by the national and local income tax laws of that country (the “Income Tax Laws”), and are generally subject to a statutory income tax rate of 25% of taxable income, which is based on the net income reported in the statutory financial statements after appropriate tax adjustment.

#### Value added tax (“VAT”)

Sales revenue represents the invoiced value of goods, net of VAT. All of the Company’s coal and coke are sold in the PRC and subject to a VAT at a rate of 17% of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing finished products. The Company records VAT payable and VAT receivable net of payments in its consolidated financial statements. The VAT tax return is filed to offset the payables against the receivables.

#### Warrants liability

A contract is designated as an asset or a liability and is carried at fair value on the Company’s balance sheet, with any changes in fair value recorded in its results of operations. The Company then determines which options, warrants and embedded features require liability accounting and records the fair value as a derivative liability. The changes in the values of these instruments are shown in the accompanying unaudited condensed consolidated statements of income and other comprehensive income as “change in fair value of warrants.”

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In connection with the Company's share exchange transaction in February 2010 with Top Favour, whereby Top Favour became a wholly-owned subsidiary of the Company (the "Share Exchange"), the Company adopted the provisions of an accounting standard regarding instruments that are indexed to an entity's own stock. This accounting standard specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in equity in the statement of financial position would not be considered a derivative financial instrument. It provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the scope exception within the standards. As a result of adopting this accounting standard, all warrants issued after the Share Exchange are recorded as a liability because their strike price is denominated in U.S. dollars, while the Company's functional currency is denominated in RMB.

All warrants issued before the Share Exchange, which were treated as equity pursuant to the derivative treatment exemption prior to the Share Exchange, are also no longer afforded equity treatment for the same reason. Since such warrants are no longer considered indexed to the Company's own stock, all future changes in their fair value will be recognized currently in earnings until they are exercised or expire.

Noncontrolling interests

As further discussed in Note 20, noncontrolling interests mainly consist of a 40% equity interest of Xingsheng Coal owned by unrelated parties. For the three months ended September 30, 2014, and 2013, there was no net income or loss attributable to such noncontrolling interests because Xingsheng Coal was not operational during such periods.

Earnings (loss) per share

The Company reports earnings per share in accordance with the provisions of ASC – 260 "Earnings per Share." This standard requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock. Dilution is computed by applying the treasury stock method. Under this method, option and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby are used to purchase common stock at the average market price during the period.

Comprehensive income

Accounting standard regarding comprehensive income establishes requirements for the reporting and display of comprehensive income, its components and accumulated balances in a full set of general purpose financial statements. This accounting standard defines comprehensive income to include all changes in equity except those resulting from investments by owners and distributions to owners. Among other disclosures, it also requires all items recognized under current accounting standards as components of comprehensive income to be reported in financial statement that is presented with the same prominence as other financial statements. The Company's only current component of comprehensive income is foreign currency translation adjustments.

Recently issued accounting pronouncements

In July 2013, the FASB issued Accounting Standards Update 2013-11, "Income Taxes (Topic 740)—Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). The objective of ASU 2013-11 is to eliminate diversity in practice of presenting unrecognized tax benefits as a liability or presenting unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss or tax credit carryforward in certain circumstances by requiring that an unrecognized tax benefit be presented in the financial statements as a reduction to deferred tax assets excluding certain exceptions. ASU 2013-11 will be effective prospectively for the Company in its first quarter of 2014. The Company does not expect ASU 2013-11 to have a material effect on its financial statements.

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In April 2014, the Financial Accounting Standards Board (the “FASB”) issued an accounting standard that raises the threshold for disposals to qualify as discontinued operations and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The standard revised the definition of a discontinued operation to cover only asset disposals that are considered to be a strategic shift with a major impact on an entity's operations and finances, such as the disposal of a major geographic area or a significant line of business. Application of the standard, which is to be applied prospectively, is required for fiscal years beginning on or after December 15, 2014, and for interim periods within that year. The Company currently plans to adopt the standard in January 2015.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-9, “Revenue from Contracts with Customers” (“ASU 2014-9”). ASU 2014-9 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The updated guidance related to revenue recognition which affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for us starting on January 1, 2017. We are currently evaluating the impact this guidance will have on our combined financial position, results of operations and cash flows.

**Note 3 – Concentration risk**

For the three months ended September 30, 2014, 82.5% of the Company's total revenues were from three major customers who individually accounted for 37.8%, 25.1% and 19.6% of total revenues, respectively. For the three months ended September 30, 2013, 71.2% of the Company's total revenues were from four major customers who individually accounted for 23.8%, 21.5%, 13.5% and 12.4% of total revenues, respectively. Accounts receivables of three customers were 24.6%, 22.2% and 15.5% of the total accounts receivable balance at September 30, 2014, respectively. Accounts receivables of two customers were 34.8% and 24.1% of the total accounts receivable balance at June 30, 2014, respectively.

For the year ended September 30, 2014, four major suppliers provided 57.4% of total raw material purchases, with each supplier individually accounting for 17.8%, 15.7%, 12.6% and 11.3% of total raw material purchases, respectively. For the year ended September 30, 2013, four major suppliers provided 59.8% of the Company's total raw material purchases, with each supplier individually accounting for 21.7%, 16.6%, 11.5% and 10.0% of total purchases, respectively. The Company held no accounts payable from its major suppliers as of September 30, 2014. Accounts payable of three suppliers were 58.5%, 8.1% and -21.0% of total accounts payable balance at June 30, 2014, respectively.

#### Note 4 – Other receivables and deposits

Other receivables and deposits consisted of the following:

|                                       | September 30,<br>2014 | June 30,<br>2014 |
|---------------------------------------|-----------------------|------------------|
| Security deposit for auction          | \$ 4,874,324          | \$4,873,928      |
| Receivables from an unrelated company | 38,700                | 29,396           |
| Advances to employees                 | 7,874                 | 6,447            |
| Interest receivable                   | 968,938               | 906,857          |
|                                       | 5,889,836             | 5,816,628        |
| Less: allowance for doubtful accounts | -                     | (29,396 )        |
|                                       | \$ 5,889,836          | \$5,787,232      |



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Security deposit for auction

On January 26, 2013, Hongli entered into an agreement with Pingdingshan Rural Credit Cooperative Union (“PRCCU”) to pay \$3,249,285 (RMB 20 million) as a security deposit to bid at an auction for some non-performing assets, including certain mining rights subject to the ongoing mine consolidation program, valued collectively at \$19.5 million (RMB 120 million). Should Hongli win the auction, the deposit would be applied against Hongli’s bid price for the assets. Otherwise, PRCCU would refund the deposit back to Hongli before September 30, 2013. On September 18, 2013, the parties entered into a supplemental agreement to postpone the auction date and to extend the deposit refund date to December 31, 2013. On September 26, 2013, the parties entered into another agreement for Hongli to pay \$1,637,000 (RMB 10 million) as additional security deposit. Should Hongli win the auction, this additional deposit would also be applied against Hongli’s bid price for the assets. Otherwise, PRCCU would refund the deposit back to Hongli before December 31, 2013. On December 30, 2013, the parties entered into a supplemental agreement to postpone the auction date and to extend the deposit refund date to December 31, 2014.

**Note 5 – Loans receivable**

On June 8, 2011, Capital Paradise Limited (“CPL”) or previously known as Ziben Tiantang Co., Ltd., an unrelated party, borrowed \$10,044,200 from Top Favour in an unsecured loan at an annual interest rate of 9.45%, with interest due every six months. The loan matured on June 7, 2012. On June 8, 2012, Top Favour and CPL entered into a supplemental agreement to extend the maturity date to December 7, 2012, and to decrease the interest rate to 7% annually.

On December 8, 2012, both parties entered into another supplemental agreement to extend the maturity date to June 8, 2013, with 7% annual interest rate. On June 8, 2013 both parties entered into another supplemental agreement to extend the maturity date to December 7, 2013, with 7% annual interest rate.

In August and September 2012, Top Favour loaned an additional \$350,000 to CPL. This loan is unsecured and has an annual interest rate of 7%, and is due on August 11, 2013. On August 2, 2013, the Company and CPL entered into a supplemental agreement to extend the remaining balance due to December 31, 2013.

On January 27, 2014, both parties agreed on a repayment schedule whereby CPL will repay 50% of the outstanding principal and accrued interest thereon before June 30, 2014, and the balance and accrued interest thereon before December 31, 2014.

CPL repaid \$6,862,163 in principal through September 30, 2014, with up to \$968,938 of interest receivables outstanding as of September 30, 2014.

For the three months ended September 30, 2014 and 2013, interest income from loans receivable amounted to \$102,081 and \$183,093, respectively.

**Note 6 – Inventories**

Inventories consisted of the following:

|   | September 30,<br>2014 | June 30,<br>2014 |
|---|-----------------------|------------------|
| Raw materials                           | \$ 275,996            | \$ 139,162       |
| Work in process                         | 886,908               | 129,726          |
| Supplies                                | 42,619                | 44,800           |
| Finished goods                          | 3,157,173             | 7,275,698        |
| Total                                   | 4,362,696             | 7,589,386        |
| Less: allowance for doubtful impairment | (169,578 )            | (169,565 )       |
| Total inventories, net                  | \$ 4,193,118          | \$ 7,419,821     |

**Note 7 – Advances to suppliers**

Most of the Company's vendors require an advance to ensure timely delivery and favorable pricing.

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Advances to suppliers amounted to \$ 8,437,466 and \$8,700,022 as of September 30, 2014 and June 30, 2013, respectively. For the three months ended September 30, 2014 and 2013, the Company did not write off any uncollectible advances to suppliers.

**Note 8 – Plant and equipment, net**

Plant and equipment consisted of the following:

|                                | September 30,<br>2014 | June 30,<br>2014 |
|--------------------------------|-----------------------|------------------|
| Buildings and improvements     | \$ 11,112,858         | \$ 11,111,956    |
| Mine development cost          | 11,740,673            | 11,739,719       |
| Machinery and equipment        | 7,509,417             | 7,508,807        |
| Other equipment                | 410,365               | 410,332          |
| Total                          | 30,773,313            | 30,770,814       |
| Less accumulated depreciation  | (16,625,094 )         | (16,344,495)     |
| Total plant and equipment, net | \$ 14,148,219         | \$ 14,426,319    |

Depreciation expense amounted to \$279,032, and \$280,236 for the three months ended September 30, 2014, and 2013, respectively. No depreciation expense was incurred for mining-related assets due to the shutdown of all coal mine operations since September 2011.

**Note 9 – Construction in progress (“CIP”)**

CIP at September 30, 2014 and June 30, 2014 amounted to \$47,425,916 and \$40,389,961, respectively, and relates to the new coking plant still under construction and coke gasification facility which was started in July 2014. The new coking plant, with an estimated construction cost of approximately \$93.98 million or RMB 578 million originally, requires an additional \$23 million or RMB 144 million to complete. The coke gasification facility, with an estimated construction cost of approximately \$7.98 million or RMB 49 million, amount unpaid to the constructor \$0.95 million or RMB 5.84 million. The remaining unpaid amount was retention money for the construction of gasification facility, which will be paid after certain months that provided as the agreements.

| Project                        | Invested cost as of<br>September 30, 2014 | Estimated cost to<br>complete | Estimated total<br>cost |
|--------------------------------|---|-------------------------------|-------------------------|
| New coking plant (1)           | \$ 70,572,416                             | \$ 23,413,253                 | \$ 93,985,669           |
| Coke gasification facility (2) | \$ 7,032,674                              | \$ 948,219                    | \$ 7,980,893            |

Due to a lack of funding, the Company has placed construction on hold until additional funding is secured. As (1) such, management is unable to estimate the completion date for CIP. No depreciation is provided for CIP until such time the asset in question is completed and placed into service.

Coke gasification facility was constructed based on our existing coking facility which was leased from Hongfeng. (2) Hongfeng granted the Company use the facility during the leasing period freely. The company believes that the leasing agreement with Hongfeng will renewed from time to time in future. The construction of coke gasification facility was completed and under the testing and calibration phase as the date of report.

#### Note 10 – Prepayments

Prepayments consisted of the following:

|                 | September 30,<br>2014 | June 30,<br>2014 |
|-----------------|-----------------------|------------------|
| Land use rights | \$ 11,396,559         | \$ 11,395,633    |
| Construction    | 50,424,095            | 50,419,999       |
| Total           | \$ 61,820,654         | \$ 61,815,632    |

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Prepayments for land use rights

Prepayments for land use rights are advances made in connection with acquiring land use rights to expand the site of the Company's new coking plant that is still under construction. The transaction is organized and guaranteed by the Bureau of Land and Resources of Baofeng County, and payments made to the former occupants of the land underlying the land use rights are not subject to refund if the transaction cannot be completed for any reason. As of September 30, 2014 and June 30, 2014, such prepayments amounted to \$11,396,559 and \$11,395,633, respectively. The Company is in the process of registering the land use right certificates with the relevant authorities and expects to complete such registrations at an estimated total cost of \$11,868,978 (RMB 73,050,000), concurrently with completing the construction of the new plant.

Prepayments for construction

Prepayments for construction consisted of the following:

|                                      | September 30,<br>2014 | June 30,<br>2014 |
|--------------------------------------|-----------------------|------------------|
| Baofeng new coking plant (1)         | \$ 20,560,739         | \$ 20,559,069    |
| Hongchang new mining tunnels (2) (6) | 1,299,820             | 1,299,714        |
| Hongchang safety instruments (3) (6) | 3,249,549             | 3,249,285        |
| Xingsheng safety instruments (4) (6) | 14,151,786            | 14,150,636       |
| Hongchang mine consolidation (5) (6) | 11,162,201            | 11,161,295       |
| Total                                | \$ 50,424,095         | \$ 50,419,999    |

(1) At June 30, 2014, the Company made prepayments of approximately \$20.6 million (RMB 126.5 million) toward construction of its new coking plant.

(2) The Company made prepayments of approximately \$1.30 million (RMB 8 million) during the year ended June 30, 2010 for constructing new mining tunnels at Hongchang coal mine.

(3) The Company made prepayments of approximately \$3.25 million (RMB 20 million) during May 2012 for upgrading the safety equipment at Hongchang coal mine.

(4) The Company made prepayments of approximately \$14.15 million (RMB 87.1 million) in August and September 2012 for upgrading the safety equipment at Xingsheng coal mine.

(5) The Company made prepayments of approximately \$11.16 million (RMB 68.7 million) during August and September 2012 for consolidating Hongchang, Shunli and Shuangrui coal mines.

As of September 30, 2014, these projects have not commenced yet, but the Company expects to do so after (6) approval from the relevant authorities. As of the date of this report, the Company had not received the approval and the Company is expecting to obtain the approval before the end of 2015.

### Note 11 – Intangible assets

Intangible assets consisted of the following:

|  | September 30,<br>2014 | June 30,<br>2014 |
|--|-----------------------|------------------|
| Land use rights                            | \$ 2,547,175          | \$ 2,546,968     |
| Mining rights                              | 44,101,629            | 44,098,046       |
| Total intangible assets                    | 46,648,804            | 46,645,014       |
| Accumulated amortization – land use rights | (760,615 )            | (742,866 )       |
| Accumulated depletion – mining rights      | (13,597,556 )         | (13,596,451 )    |
| Total intangible assets, net               | \$ 32,290,633         | \$ 32,305,697    |

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Amortization expense for the three months ended September 30, 2014 and 2013 amounted to \$17,674, and \$17,659, respectively. No depletion was incurred due to the shutdown of all coal mine operations since September 2011. Depletion expense will be charged to cost of revenue in the period incurred using the unit-of-production method.

Amortization expense of the land use rights for the next five years and thereafter is as follows:

| Year ending June 30, | Amortization expense |
|----------------------|----------------------|
| 2015                 | \$ 53,021            |
| 2016                 | 70,694               |
| 2017                 | 70,694               |
| 2018                 | 70,694               |
| 2019                 | 70,694               |
| Thereafter           | 1,450,763            |
| Total                | \$ 1,786,560         |

**Note 12 – Long-term investments and refundable deposit**

Long-term investments consisted of investments accounted for using the cost and equity methods.

In February 2011, the Company invested approximately \$1.3 million (RMB 8 million) in Pingdingshan Xinhua District Rural Cooperative Bank (“Cooperative Bank”). This investment represents 2.86% interest in Cooperative Bank, and is accounted for under the cost method. No investment income was received and recognized during the three months ended September 30, 2014 and 2013

In April 2011, Hongyuan CSG was established by Zhonghong (49%) and Henan Coal Seam Gas (51%) as a joint venture. The total registered capital of Hongyuan CSG is approximately \$15.85 million (RMB 100 million). As of June 30, 2012, approximately \$3.17 million (RMB 20 million) was funded, of which \$1.6 million (RMB 9.8 million) was paid by Zhonghong. The remaining registered capital was due on April 20, 2013, of which approximately \$6.2 million (RMB 39.2 million) will be paid by Zhonghong. Zhonghong’s investment in Hongyuan CSG is accounted for under the equity method since Zhonghong has significant influence but not control. As of the date of this report, Zhonghong has not contributed the remaining registered capital as Hongyuan CSG has remained inactive. Zhonghong

and Henan Coal Seam Gas are in the process of negotiating with the appropriate PRC authorities to extend the due date for the outstanding registered capital.

In addition, a deposit of \$4,874,324 was made on December 23, 2011 to Henan Coal Seam Gas and is refundable when the joint venture commences operation.

For the three months ended September 30, 2014 and 2013, there was no equity investment income or loss.

### **Note 13 – Loans**

#### Loans from Bairui Trust

On April 2, 2011, Hongli entered into a loan agreement with Bairui Trust pursuant to which Bairui Trust agreed to loan Hongli approximately \$58.4 million (RMB 360 million) with annual interest of 6.3%, of which approximately \$29.2 million (RMB 180 million) would be due on April 2, 2013, and approximately \$29.2 million (RMB 180 million) on April 2, 2014. The loan was issued on April 3, 2011 and is guaranteed by Hongyuan and the Company's CEO.

On November 30, 2011, the parties entered into a supplemental agreement pursuant to which approximately \$4.88 million (RMB 30 million) with annual interest of 6.3% became due on October 2, 2012, approximately \$16.23 million (RMB 100 million) with annual interest of 6.3%, became due on April 2, 2013, approximately \$8.11 million (RMB 50 million) with annual interest of 6.3% became due on October 2, 2013, and approximately \$29.2 million (RMB 180 million) with annual interest of 6.3% became due on April 2, 2014.



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For the payment due October 2, 2012, the parties entered into a separate agreement on October 8, 2012 to extend the due date to April 2, 2013 with an annual interest rate of 8.7% starting October 3, 2012. Such payment was paid in full on December 25, 2012.

For the payment due April 2, 2013, the Company paid \$3.25 million (RMB 20 million) on April 3, 2013, and entered into a separate agreement with Bairui Trust on April 23, 2013 to extend the due date for the remaining \$13.01 million (RMB 80 million) as follows: (a) \$3.25 million (RMB 20 million) was extended to December 2, 2013 with an annual interest rate of 6.3% starting April 23, 2013; (b) \$4.88 million (RMB 30 million) was extended to January 2, 2014 with an annual interest rate of 6.3% starting April 23, 2013; and (c) \$4.88 million (RMB 30 million) was extended to February 2, 2014 with an annual interest rate of 6.3% starting April 23, 2013. For the period between April 3, 2013 and April 23, 2013, Bairui Trust charged 9.45% annual interest rate on the entire \$13.01 million outstanding.

On October 1, 2013, the parties executed an extension agreement, for the remaining balance of approximately \$50.3 million (RMB 310 million) with 9.9% annual interest rate as follow:

| Loan Amount<br>(in USD) | Loan Amount<br>(in RMB) | Extended Loan<br>Repayment Date | New Interest Rate Period            |
|-------------------------|-------------------------|---------------------------------|-------------------------------------|
| \$ 8,114,380            | ¥ 50,000,000            | October 2, 2016                 | October 3, 2013 – October 2, 2016   |
| 3,245,752               | 20,000,000              | December 2, 2016                | December 3, 2013 – December 2, 2016 |
| 4,868,628               | 30,000,000              | January 2, 2017                 | January 3, 2014 – January 2, 2017   |
| 4,868,628               | 30,000,000              | February 2, 2017                | February 3, 2014 – February 2, 2017 |
| 29,211,770              | 180,000,000             | April 2, 2017                   | April 3, 2014 – April 2, 2017       |
| \$ 50,309,158           | ¥ 310,000,000           |                                 |                                     |

On April 2, 2014, the Company entered into another supplement agreement with Bairui Trust which replaced the extension agreement dated October 1, 2013, and repaid the principal \$324,929 (RMB 2,000,000). Per the supplement agreement, loans from Bairui Trust were changed as follows:

| Loan Amount<br>(in USD) | Loan Amount<br>(in RMB) | Extended Loan<br>Repayment Date | New Interest Rate Period          |
|-------------------------|-------------------------|---------------------------------|-----------------------------------|
| \$ 2,924,594            | ¥ 18,000,000            | April 2, 2015                   | December 3, 2013 – April 2, 2015  |
| 4,874,324               | 30,000,000              | April 2, 2015                   | January 3, 2014 – April 2, 2015   |
| 4,874,324               | 30,000,000              | April 2, 2015                   | February 3, 2014 – April 2, 2015  |
| 8,123,872               | 50,000,000              | January 2, 2015                 | October 3, 2013 – January 2, 2015 |
| 29,245,942              | 180,000,000             | October 2, 2015                 | April 3, 2014 – October 2, 2015   |
| \$ 50,043,056           | ¥ 308,000,000           |                                 |                                   |

According to the new supplement agreement dated April 2, 2014, the annual interest rate was changed from 9.9% to 11.88% and, for the period between December 3, 2013 and April 2, 2014, Bairui Trust charged the Company an additional 7.2% annual interest rate on \$12.9 million (RMB 80 million) of the outstanding \$50.3 million (RMB 310 million) loan principal.

Weighted average interest rate was 11.8% and 6.2% for the three months ended September 30, 2014 and June 30, 2014, respectively. Interest expense for three months end September 30, 2014 and 2013 amounted to \$1,497,213 and \$778,767, respectively. No interest was capitalized into CIP.

#### **Note 14 – Other payables and accrued liabilities**

Other payables mainly consisted of accrued salaries, interest payable, utilities, professional services and other general and administrative expenses.

Other payables and accrued liabilities consisted of the following:

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|                            | September 30,<br>2014 | June 30,<br>2014 |
|----------------------------|-----------------------|------------------|
| Other payable              | \$ 318,505            | \$264,522        |
| Interest payable           | 1,390,853             | 2,017,946        |
| Accrued liabilities (1)(2) | 173,487               | 177,645          |
| Total                      | \$ 1,882,845          | \$2,460,113      |

(1) As of September 30, 2014, and June 30, 2014, \$60,000 and \$0 of salary payable included in accrued liabilities was payable to the Company's CEO.

(2) As of September 30, 2014, and June 30, 2014, \$30,000 and \$60,000 of salary payable included in accrued liabilities was payable to the Company's current CFO.

**Note 15 – Related party payables**

Other payables-related parties represent advances from the Company's CEO. Advances from the CEO amounted to \$2,544,833 and \$526,699 at September 30, 2014 and June 30, 2014, respectively. Such advances are interest free, due on demand and will be settled in cash.

On July 2, 2014, Mr. Lv Jianhua, the CEO of the Company, repaid the interest payable of \$2,017,946 to Baidu Trust on behalf of the Company.

**Note 16 – Acquisition payables**

On August 10, 2010, Hongli acquired 60% of the equity interest of Shuangrui Coal (see Note 20). During the year ended June 30, 2012, Hongli agreed to acquire the remaining 40%. The title thereof was transferred to Hongli, and Hongli had full control of Shuangrui Coal by June 30, 2012. The purchase price thereof was tentatively set at approximately \$4,544,053 (RMB 28 million), subject to certain price adjustments to be finalized at closing. The balance is due on demand. As of September 30, 2014 and June 30, 2014, acquisition payable was \$4,711,846 and \$4,711,463, respectively, which represented the accrued purchase price for the remaining 40% of Shuangrui Coal.

**Note 17 – Taxes**

Income tax

SinoCoking is subject to the United States federal income tax provisions. Top Favour is a tax-exempt company incorporated in the British Virgin Islands.

All of the Company's businesses are conducted by its PRC subsidiary and VIEs, namely Hongyuan, Hongli, Baofeng Coking, Hongchang Coal, Xingsheng Coal, Shuangrui Coal, Hongguang Power and Zhonghong. All of them excepting Hongchang Coal are subject to 25% enterprise income tax rate in China. Hongchang Coal has not been required to pay income tax since its operations were halted in September 2011.

The provision for income taxes consisted of the following:

|                                 | For the three months ended<br>September 30, |            |
|---------------------------------|---|------------|
|                                 | 2014  | 2013       |
| U.S. current income tax expense | \$ -  | \$ -       |
| BVI current income tax expense  | -   | -          |
| PRC current income tax expense  | 489,853                                     | 633,757    |
| Total                           | \$ 489,853                                  | \$ 633,757 |

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SinoCoking has incurred a net operating loss for income tax purposes for 2014. As of September 30, 2014, the estimated net operating loss carry forwards for U.S. income tax purposes was approximately \$3,063,000, which may be available to reduce future years taxable income. The net operating loss carry forward will expire through 2034 if not utilized. Management believes that the realization of the benefits arising from this loss appears to be uncertain due to the Company's limited operating history and continuing losses for U.S. income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at September 30, 2014 and June 30, 2014, respectively. Management reviews this valuation allowance periodically and makes adjustments as necessary.

The following table reconciles the valuation allowance for the year ended September 30, 2014 and June 30, 2014, which consisted of the following:

|                   | For the three months ended September 30 |            |
|-------------------|---|------------|
|                   | 2014                                    | 2013       |
| Beginning balance | \$ 1,042,000                            | \$ 715,000 |
| Additions         | 689,000                                 | 29,000     |
| Ending balance    | \$ 1,731,000                            | \$ 744,000 |

Value added tax

The Company incurred VAT on sales and VAT on purchases in the PRC as follows:

|                  | For the three months ended September 30, |              |
|------------------|--|--------------|
|                  | 2014                                     | 2013         |
| VAT on sales     | \$ 3,863,167                             | \$ 5,766,847 |
| VAT on purchases | \$ 2,817,948                             | \$ 4,966,582 |

Sales and purchases are recorded net of VAT collected and paid, as the Company acts as an agent for the PRC government.

Taxes payable

Taxes payable consisted of the followings:

|            | September 30,<br>2014 | June 30,<br>2014 |
|------------|-----------------------|------------------|
| VAT        | \$ 667,050            | \$(47,378 )      |
| Income tax | 797,355               | 643,498          |
| Others     | 227,453               | 169,301          |
| Total      | \$ 1,691,858          | \$765,421        |

### Note 18 – Capital transactions

#### Common Stock:

On September 24, 2014, the Company completed a registered sale of its common stock with two institutional investors under its shelf registration statement on Form S-3 pursuant to a Securities Purchase Agreement executed on September 18, 2014. Gross proceeds from the offering were approximately \$14.3 million in exchange of 2,818,845 shares of the Company's common stock. After payment of expenses, the Company received approximately \$13.2 million in net proceeds. In addition, the Company issued to the investors Series A warrants ("Warrants A") to purchase an aggregate of 1,409,423 common shares and Series B warrants ("Warrants B") to purchase an aggregate of 1,644,737 common shares. Under the Purchase Agreement, the investors also had an option to purchase additional 1,644,737 shares of the Company's common stock and warrants – Series C ("Warrants C") to purchase 822,369 shares of the Company's common stock. If fully exercised, the Company would receive aggregate gross proceeds from the warrants of approximately \$18.9 million.

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Options:

Under the 2002 Stock Option Plan for Directors, options exercisable for 1,666 shares of the Company's common stock at \$36.00 per share were granted on October 11, 2002, and expired on October 15, 2012. Options exercisable for 3,126 shares of the Company's common stock at \$96.00 per share were granted on November 16, 2004, and will expire on November 16, 2014.

Under the 1999 Stock Option Plan, options exercisable for 6,059 shares of the Company's common stock at \$96.00 per share were granted on November 14, 2004, and will expire on November 14, 2014. Such options were fully vested before the Share Exchange on February 5, 2010.

On September 24, 2014, the Company closed an initial offering with two institutional investors pursuant to a securities purchase agreement ("Purchase Agreement") date on September 18, 2014. Under the Purchase Agreement, the investors also had an option to purchase additional 1,644,737 shares of the Company's common stock and warrants – Series C ("Warrants C") to purchase 822,369 shares of the Company's common stock for a period beginning six months and one day from September 24, 2014 and ending ten months from September 24, 2014. The expiration date for Warrants C will be the fourth anniversary of September 24, 2014.

Options outstanding and exercisable at September 30, 2014 are as follows:

| Outstanding options |                       |                        | Exercisable options |                       |                        |
|---------------------|-----------------------|------------------------|---------------------|-----------------------|------------------------|
| Number              | Average contract life | Average exercise price | Number              | Average contract life | Average exercise price |
| remaining           |                       |                        | remaining           |                       |                        |
| of options          |                       |                        | of options          |                       |                        |
| 9,185               | 0.123 years           | \$ 96.00               | 9,185               | 0.123 years           | \$ 96.00               |
| 1,644,737           | 0.814 years           | \$ 6.08                | N/A                 | N/A                   | N/A                    |

The following is a summary of changes in options activities:

|                                 | Outstanding options |               |           |
|---------------------------------|---------------------|---------------|-----------|
|                                 | Exercisable         | Unexercisable | Total     |
| Outstanding, June 30, 2013      | 9,185               | -             | 9,185     |
| Granted                         | -                   | -             | -         |
| Forfeited                       | -                   | -             | -         |
| Exercised                       | -                   | -             | -         |
| Outstanding, June 30, 2014      | 9,185               | -             | 9,185     |
| Granted                         | -                   | 1,644,737     | 1,644,737 |
| Forfeited                       | -                   | -             | -         |
| Exercised                       | -                   | -             | -         |
| Outstanding, September 30, 2014 | 9,185               | 1,644,737     | 1,653,922 |

### Warrants

As of September 30, 2014 and June 30, 2014, warrants that were exercisable for 3,906,853 shares of the Company's common stock were recorded as derivative instruments. The value of warrant liabilities was \$12,075,294 and \$16 at September 30, 2014 and June 30, 2014, respectively. The decrease (increase) in fair value of warrants was \$(2,027,162) and \$12 for three months ended September 30, 2014 and 2013, respectively, and was recorded as gain (loss) on change in fair value of warrants.



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On September 24, 2014, the Company closed an initial offering with two institutional investors pursuant to a securities purchase agreement (“Purchase Agreement”) dated on September 18, 2014. The initial offering included Warrants A and Warrants B. The Warrants A grants investors to purchase an aggregate of 1,409,423 shares of the Company’s common stock, which is exercisable immediately as of the date of the issuance, which was September 24, 2014, at an exercise price of \$6.38 per common share and will be expired after four years from the date of issuance. Warrants B to purchase 1,644,737 shares of common stock at an exercise price of \$6.08 are exercisable for six months starting from September 24, 2014 and may become exercisable only to the extent that the Company does not have an effective registration statement available for the shares underlying such warrants and in any event expire after certain registration conditions are satisfied. The expiration date for Warrants B will be (1) if no registration failure has occurred, the date will be July 25, 2015, or (2) if a registration failure has occurred, the date will be September 24, 2018. As of September 30, 2014, Warrants B were not exercisable.

Under the Purchase Agreement, the investors also had an option to purchase additional 1,644,737 shares of the Company’s common stock and Warrants C to purchase 822,369 shares of the Company’s common stock for a period beginning six months and one day from September 24, 2014 and ending ten months from September 24, 2014. The expiration date for Warrants C will be the fourth anniversary of September 24, 2014.

The following is a summary of changes in warrant activities:

|                                 | Existing Warrants at \$48 (1) | Investor Warrants at \$12 (2) | Callable Warrants (3) (6) | Warrants at \$11 (4) | Callable Warrants at \$6 (4) (6) | Callable Warrants at \$15 (5) (6) | Warrants A at \$6.38 (7) | Placement Agent Warrants at \$6.38 (8) | Warrants B at \$6.08 (9) | Warrants C at \$6.08 (10) | Totals    |
|---------------------------------|-------------------------------|-------------------------------|---------------------------|----------------------|----------------------------------|-----------------------------------|--------------------------|--|--------------------------|---------------------------|-----------|
| Outstanding, June 30, 2013      | 36,973                        | 590,446                       | 3,082,027                 | 117,163              | 30,244                           | 50,000                            | -                        | -                                      | -                        | -                         | 3,896,853 |
| Granted                         | -                             | -                             | -                         | -                    | -                                | -                                 | -                        | -                                      | -                        | -                         | -         |
| Forfeited                       | -                             | -                             | -                         | -                    | -                                | -                                 | -                        | -                                      | -                        | -                         | -         |
| Exercised                       | -                             | -                             | -                         | -                    | -                                | -                                 | -                        | -                                      | -                        | -                         | -         |
| Outstanding, June 30, 2014      | 36,973                        | 590,446                       | 3,082,027                 | 117,163              | 30,244                           | 50,000                            | -                        | -                                      | -                        | -                         | 3,896,853 |
| Granted                         | -                             | -                             | -                         | -                    | -                                | -                                 | 1,409,423                | 225,508                                | 1,644,737                | 822,369                   | 4,101,837 |
| Forfeited                       | -                             | -                             | -                         | -                    | -                                | -                                 | -                        | -                                      | -                        | -                         | -         |
| Exercised                       | -                             | -                             | -                         | -                    | -                                | -                                 | -                        | -                                      | -                        | -                         | -         |
| Outstanding, September 30, 2014 | 36,973                        | 590,446                       | 3,082,027                 | 117,163              | 30,244                           | 50,000                            | 1,409,423                | 225,508                                | 1,644,737                | 822,369                   | 8,001,693 |

(1) The warrants underlying 36,973 shares are exercisable at any time until April 9, 2017, with remaining contractual term of 2.53 years as of September 30, 2014.

(2) The warrants underlying 590,446 shares are exercisable at any time until February 5, 2015, with remaining contractual term of 0.35 years as of September 30, 2014.

The warrants underlying 3,082,027 shares and 117,163 shares are exercisable at any time until March 11, 2015 and  
(3) March 18, 2015, respectively, with remaining contractual term of 0.44 and 0.46 years as of September 30, 2014, respectively.

(4) The warrants underlying 30,244 shares are exercisable until March 11, 2015, with remaining contractual term of 0.44 years as of September 30, 2014.

(5) The warrants underlying 50,000 shares are exercisable until July 1, 2015, with remaining contractual terms of 0.75 years as of September 30, 2014.

The callable warrants are exercisable for a period of five years from the date of issuance, and are callable at the Company's election six months after the date of issuance if the Company's common stock trades at a price equal to  
(6) at least 150% of the exercise price with an average trading volume of at least 150,000 shares of common stock (as adjusted for any stock splits, stock dividends, combination and the like) per trading date for at least 10 consecutive trading days, and the underlying shares of common stock are registered.

(7) Warrants A underlying 1,409,423 shares are exercisable at any time until September 24, 2018, with remaining contractual term of 3.99 years as of September 30, 2014.

(8) The warrants issued to the placement agent underlying 225,508 shares are exercisable at any time until September 24, 2018, with remaining contractual term of 3.99 years as of September 30, 2014.

Warrants B to purchase 1,644,737 shares of common stock are exercisable for six months starting from September 24, 2014 and may become exercisable only to the extent that the Company does not have an effective registration statement available for the shares underlying such warrants and in any event expire after certain registration  
(9) conditions are satisfied. The expiration date for Warrants B will be (1) if no registration failure has occurred, the date will be July 25, 2015, or (2) if a registration failure has occurred, the date will be September 24, 2018. As of September 30, 2014, Warrants B were not exercisable.

Under the Share Purchase agreement, the investors were granted an option to purchase additional 1,644,737  
(10) shares of the Company's common stock and Warrants C to purchase 822,369 shares of the Company's common stock for a period beginning March 25, 2015 and ending July 24, 2015. The expiration date for Warrants C will be the fourth anniversary of September 24, 2014. As of September 30, 2014, Warrants C were not exercisable.

**Note 19 – Earnings per share**

The following is a reconciliation of the basic and diluted earnings (loss) per share computation:

|   | For the three months ended September 30, |                |
|---|--|----------------|
|   | 2014                                     | 2013           |
| Net income for earnings per share                           | \$ (2,553,257                            | ) \$ 1,160,884 |
| Weight average shares used in basic and diluted computation | 21,310,527                               | 21,121,372     |
| Earnings per share – basic and diluted                      | \$ (0.12                                 | ) \$ 0.05      |

The Company had warrants and options exercisable for 5,550,969 shares of common stock in the aggregate at September 30, 2014 and June 30, 2014, respectively. For the three months ended September 30, 2014 and 2013, all outstanding options and warrants were excluded from the diluted earnings per share calculation since they were anti-dilutive.

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**Note 20- Coal mine acquisitions**

On May 20, 2011, the Company acquired 60% of the equity interests of Shuangrui Coal and Xingsheng Coal, and 100% of the equity interests of Shunli Coal.

In August and September 2011, the Company entered into supplemental agreements with the sellers of these three companies (collectively the "Supplement Agreements") to memorialize certain agreed terms that were not reflected in the original purchase agreements. Specifically, all assets and liabilities of each company on or before the closing of the Company's acquisition, other than such company's mining rights, would be disposed of and assumed by the sellers as soon as practicable. At June 30, 2011, the Company's acquisition of these three companies included only their mining rights, as all other assets and liabilities were being disposed of by the sellers, and none of the three companies was operational. Therefore, the operating results of these three companies (other than with respect to their mining rights) from May 20, 2011 through June 30, 2014, which were mainly from disposing assets and liabilities (other than their mining rights), are not included in the accompanying consolidated financial statements.

Although the Company has acquired the equity interests of these three entities, the parties' intention, as memorialized in the Supplemental Agreements, is for the Company to acquire only their mining rights while all other assets and liabilities remain with the sellers. Thus, the respective purchase prices have been allocated solely to the mining rights.

Acquisition of Shuangrui Coal

On August 10, 2010, Hongli entered into an equity purchase agreement to acquire 60% of Shuangrui Coal, which operates Shuangrui coal mine, for a consideration of approximately \$6.4 million (RMB 42 million), payable in cash. Transfer of such equity interests to Hongli, and registration of such transfer with the appropriate PRC authorities, were completed on May 20, 2011. As memorialized in the Supplement Agreement with the sellers, all assets and liabilities of Shuangrui Coal at the time of Hongli's acquisition, other than its mining rights, are to be disposed of and/or assumed by the sellers. As such, Hongli's acquisition consideration is equivalent to the purchase price for 60% ownership of Shuangrui's mining rights. As of June 30, 2014, approximately \$6.66 million (RMB 41 million) was paid. During the year ended June 30, 2012, Hongli acquired the remaining 40% and then transferred 100% of its ownership to Hongchang. As a result, the Company accrued \$4,463,200 (RMB 28 million) payable to Shuangrui Coal's sellers (see Note 16).

Acquisition of Xingsheng Coal

On August 10, 2010, Hongli entered into an equity purchase agreement to acquire 60% of Xingsheng Coal, which operates the Xingsheng Mine, for a consideration of approximately \$6.7 million (RMB 42 million), payable in cash. Transfer of such equity interests to Hongli, and registration of such transfer with the appropriate PRC authorities, were completed on May 20, 2011. As memorialized in the Supplement Agreement with the sellers, all assets and liabilities of Xingsheng Coal at the time of Hongli's acquisition, other than its mining rights, are to be disposed of and/or assumed by the sellers. As such, Hongli's acquisition consideration is equivalent to the purchase price for 60% ownership of Xingsheng's mining rights. The purchase price was paid in full in June 2011.

Acquisition of Shunli Coal

On May 19, 2011, Hongchang Coal entered into an equity purchase agreement to acquire 100% of Shunli Coal, which operates the Shunli Mine, for a consideration of approximately \$6.7 million (RMB 42 million), payable in cash. Transfer of such equity interests to Hongchang, and registration of such transfer with the appropriate PRC authorities, were completed on May 20, 2011. As memorialized in the Supplement Agreement with the sellers, all assets and liabilities of Shunli Coal at the time of Hongli's acquisition, other than its mining rights, were to be disposed of and/or are assumed by the sellers. As such, Hongli's acquisition consideration is equivalent to the purchase price for 100% ownership of Shunli's mining rights. The purchase price was paid in full in June 2011. On July 2, 2012, Shunli Coal and Hongchang Coal entered into an agreement to transfer all of Shunli Coal's mining rights to Hongchang Coal, in connection with the Company's plans to consolidate mining areas under Hongchang Coal for future production. On July 4, 2012, Shunli Coal was dissolved.

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Since the initial accounting for these acquisitions were for the mining rights only, the entire purchase price was allocated to the mining rights. The mining rights acquired are not being amortized because the businesses have not commenced any operations since their acquisitions.

**Note 21 – Commitments and contingencies**

Lease agreement

On April 12, 2013, the Company signed a lease agreement with Pingdingshan Hongfeng Coal Processing and Coking, Ltd., (“Hongfeng Coal”). Per the agreement, the Company may utilize Hongfeng Coal’s coke production facility, which has an annual capacity of 200,000 metric tons, for a period of one year. In exchange, the Company agreed to pay Hongfeng Coal \$9.60 (RMB 60) per metric ton of coke produced from the leased facility. On April 8, 2014, the Company renewed the agreement for another year.

Purchase commitment

The Company entered into several contracts with contractors and suppliers for the following projects:

|                              | Aggregate contract amount | Payments made | Purchase commitment |
|------------------------------|---------------------------|---------------|---------------------|
| Baofeng new coking plant     | \$ 64,307,412             | \$ 57,058,775 | \$ 7,248,637        |
| Hongchang new mining tunnels | 1,515,915                 | 1,299,820     | 216,095             |
| Hongchang safety instruments | 7,012,527                 | 3,249,549     | 3,762,978           |
| Xingsheng safety instruments | 19,680,894                | 14,151,786    | 5,529,108           |
| Hongchang mine consolidation | 32,903,310                | 11,162,201    | 21,741,109          |
| Coke gasification facility   | 7,980,893                 | 7,032,674     | 948,219             |
| Total                        | \$ 133,400,951            | \$ 93,954,805 | \$ 39,446,146       |

**Note 22 – Statutory reserves**

Applicable PRC laws and regulations require that before a foreign invested enterprise can legally distribute profits, it must first satisfy all tax liabilities, provide for losses in previous years, and make allocations, in proportions determined at the discretion of the board of directors, after the statutory reserves. The statutory reserves include the statutory surplus reserve fund and the enterprise expansion fund.

Each of the Company's subsidiary and VIEs in the PRC is required to transfer 10% of its net income, as determined in accordance with the PRC Company Law, to a statutory surplus reserve fund until such reserve balance reaches 50% of each such entity's registered capital. The transfer must be made before distribution of any dividends to shareholders. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholdings or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

The enterprise fund may be used to acquire plant and equipment or to increase the working capital to expend on production and operation of the business. No minimum contribution is required

As of September 30, 2014, the statutory surplus reserves of Hongchang Coal and Hongli had reached 50% of each entity's registered capital. Hongguang Power, Shuangrui Coal, Xingsheng Coal and Shunli Coal did not make any contribution to the statutory reserve due to their respective operating loss. Zhonghong and Hongrun did not make any contribution as neither entity had operations.



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Hongchang Coal is required by the PRC government to reserve safety and maintenance expense to the cost of production based on the actual quantity of coal exploited. The amount of reserves is determined within the unit price range provided by Ministry of Finance of PRC. Currently, Hongchang Coal reserves at RMB 6 per metric ton for safety expense and RMB 8.5 per metric ton for maintenance expense. Shuangrui Coal, Xingsheng Coal and Shunli Coal had no such reserve as of June 30, 2014.

The component of statutory reserves and the future contributions required pursuant to PRC Company Law are as follows:

|                           | September 30,<br>2014 | June 30,<br>2014 | 50% of registered<br>capital | Future<br>contributions<br>required as of<br>September 30,<br>2014 |
|---------------------------|-----------------------|------------------|------------------------------|--|
| Hongli                    | \$ 2,067,215          | \$2,067,215      | \$ 2,064,905                 | \$ -   |
| Hongguang Power           | -                     | -                | 1,514,590                    | 1,514,590  |
| Hongchang Coal            | 218,361               | 218,361          | 218,361                      | -  |
| Shuangrui Coal            | -                     | -                | 310,105                      | 310,105  |
| Xingsheng Coal            | -                     | -                | 279,682                      | 279,682  |
| Hongrun                   | -                     | -                | 2,310,000                    | 2,310,000  |
| Hongyuan                  | -                     | -                | 1,500,000                    | 1,500,000  |
| Zhonghong                 | -                     | -                | 1,521,990                    | 1,521,990  |
| Statutory surplus reserve | 2,285,576             | 2,285,576        | 9,719,633                    | 7,436,367  |
| Mine reproduction reserve | 1,404,365             | 1,404,365        | -                            | -  |
| Total                     | \$ 3,689,941          | \$3,689,941      | \$ 9,719,633                 | \$ 7,436,367   |

**Note 23 – Revenues by products**

The Company considers itself, including its coal mining and coking operations and the sales of its coal and coke products, to be operating within one reportable segment. All of the Company's products are sold within the PRC. Major products and respective for the three months ended September 30, 2014 and 2013 are summarized as follows:

For the three months ended September 30,

|               | 2014          | 2013          |
|---------------|---------------|---------------|
| Coke          | \$ 11,190,216 | \$ 11,261,070 |
| Coal tar      | 465,322       | 605,348       |
| Crude benzol  | 378,790       | 68,994        |
| Coke power    | -             | 840,709       |
| Coal slurries | 101,954       | 158,471       |
| Mid-coal      | 362,264       | 375,608       |
| Washed coal   | 1,075,290     | 4,165,770     |
| Raw coal      | -             | -             |
|               | \$ 13,573,836 | \$ 17,475,970 |

**Note 24 – Subsequent event**

On October 20, 2014, Underground coal gasification construction was started. The construction was scheduled to complete in about February 2015.

**ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
2. OF OPERATIONS**

*The following discussion and analysis of the results of our operations and financial condition for the three months ended September 30, 2014 and 2013, should be read in conjunction with our financial statements and the notes thereto that are included elsewhere in this report. All monetary figures are presented in U.S. dollars, unless otherwise indicated.*

**Overview**

We are a vertically-integrated coal and coke producer based in Henan Province, People's Republic of China ("PRC" or "China"). Our products currently include raw coal, washed coal, "medium" or mid-coal, coal slurries, coke, coal tar and crude benzol, although we anticipate continuing to reduce our reliance on coal products and expand into the clean energy industry. We also generate electricity from gas emitted during the coking process, which we use primarily to power our operations.

In May 2014, we commenced plans to further extend our coal and coke operations into the clean-burning synthetic gas field. During the beginning of July 2014, we started an investment plan of approximately \$7.8 million or RMB 48 million to build a coke gasification facility for the conversion of carbon dioxide into a clean-burning synthetic gas ("syngas"). The construction was completed near the end of September 2014 and commenced its production in the middle of October 2014. The annual capacity of the coke gasification facility is designed at 219,000,000 cubic meters of syngas or 25,000 cubic meters of syngas per hour.

On August 28, 2014, we also entered into a cooperative agreement with North China Institute of Science and Technology regarding underground coal gasification development to refine and implement a technology to convert our coal mines with 2.3 million tons of coal recovery reserves into syngas. At the first phase of this cooperation, we will invest \$18 million in building an underground coal gasification facility with an annual production capacity of 525,600,000 cubic meters of syngas or 60,000 cubic meters of syngas per hour. The construction commenced in October 2014 and is expected to complete in February 2015. Our target is to build an underground coal gasification facility with an annual production capacity of 7,708,800,000 cubic meters of syngas or 880,000 cubic meters of syngas per hour. The required funding is expected to come from our operations and loans from financial institutions.

With the coke and coal gasification implementation plans, we plan to transition from being a producer of coal and coke products to a multifunctional energy company engaged in providing coal, coke, and clean-burning syngas.

Our business operations are conducted by Henan Province Pingdingshan Hongli Coal & Coke Co., Ltd. (“Hongli”), which we control through contractual arrangements that Hongli and its owners have entered into with Pingdingshan Hongyuan Energy Science and Technology Development Co., Ltd. (“Hongyuan”), a wholly-owned subsidiary of Top Favour Limited (“Top Favour”), a British Virgin Island company and our wholly owned subsidiary. These contractual arrangements provide for management and control rights, and in addition entitle us to receive the earnings and control the assets of Hongli. Other than our interests in the contractual arrangements, we do not own any equity interests in Hongli.

As of September 30, 2014,:

Coking related operations, including coke gasification, are carried out by Hongli and its branch, Baofeng Coking Factory (“Baofeng Coking”).

Coal related operations, including underground coal gasification, are under the following three subsidiaries of Hongli, although all mining activities are currently on hold pending the ongoing mining moratorium:

- (1) Baofeng Hongchang Coal Co., Ltd. (“Hongchang Coal”);
- (2) Baofeng Shuangrui Coal Mining Co., Ltd. (“Shuangrui Coal”), which is wholly owned by Hongchang Coal; and
- (3) Baofeng Xingsheng Coal Mining Co., Ltd. (“Xingsheng Coal”).

Electricity generation is carried out by Baofeng Hongguang Environment Protection Electricity Generating Co., Ltd. (“Hongguang Power”), also a wholly owned subsidiary of Hongli.

The coal-related activities for the periods discussed below are those of Hongchang Coal only, although its mining operations were halted in September 2011. Our other coal mine companies have halted operations since the provincial-wide mining moratorium was imposed in June 2010. As of the date of this report, we do not know when the

mining moratorium will be lifted, or when we can resume our mining operations, if at all.

We intend to transfer all coal mining operations from Hongli's subsidiaries to a joint-venture established with Henan Province Coal Seam Gas Development and Utilization Co., Ltd. ("Henan Coal Seam Gas"), a state-owned enterprise and qualified provincial-level coal mine consolidator. The joint-venture, Henan Hongyuan Coal Seam Gas Engineering Technology Co., Ltd. ("Hongyuan CSG"), has been established, although our planned transfer of coal related activities to Hongyuan CSG has not been carried out as of the date of this Report. Our interests in Hongyuan CSG are held by Henan Zhonghong Energy Investment Co., Ltd. ("Zhonghong"), which equity interests are presently held on Hongli's behalf and for its benefit by three nominees pursuant to share entrustment agreements.

## Results of Operations

Our revenue for the three months ended September 30, 2014 decreased by approximately 22.33% from a year ago as sales of most products slowed, largely as a result of government policies aimed at reducing pollution and softness in the real estate markets which affected demand for steel and as result, coal and coke products. We derived 89% of our revenue from coke products for the three months ended September 30, 2014, as compared to 73% for the three months ended September 30, 2013, and 11% from coal products for the three months ended September 30, 2014 as compared to 27% for the three months September 30, 2013.

On a macro level, management has observed the following trends, which may have a direct impact on our operations in the near future: (1) China's domestic coke market can be expected to remain soft until the Chinese steel industry can work through its oversupply of crude steel, which may take some time absent any sudden, sharp uptick in the economy; and (2) the slower economy, along with an oversupply of mid-coal starting in early 2013, will continue to keep mid-coal price down.

### *Comparison of the three months ended September 30, 2014 and 2013*

#### Revenue

Revenue decreased by \$3,902,134 as compared to the same period last year. Such decrease mainly resulted from decreased sales of coke, washed coal, coke power, coke tar, coal slurry and mid coal, offset by increased sales of crude benzol. Revenue and quantity sold by product type for the three months ended September 30, 2014 and 2013 are as follows:

|                                       | Revenues      |               |                |
|---------------------------------------|---------------|---------------|----------------|
|                                       | Coke products | Coal products | Total          |
| Revenue                               |               |               |                |
| Three months ended September 30, 2013 | \$12,776,121  | \$4,699,849   | \$17,475,970   |
| Three months ended September 30, 2014 | 12,034,328    | 1,539,508     | 13,573,836     |
| Increase (decrease) in \$             | \$(741,793 )  | \$(3,160,341) | \$(3,902,134 ) |
| Increase (decrease) in %              | (5.81 )%      | (67.24 )%     | (22.33 )%      |
| Quantity sold (metric tons)           |               |               |                |
| Three months ended September 30, 2013 | 58,274        | 36,763        | 95,037         |
| Three months ended September 30, 2014 | 60,357        | 18,515        | 78,872         |

|                                    |        |           |           |
|------------------------------------|--------|-----------|-----------|
| Increase (decrease) in metric tons | 2,083  | (18,248 ) | (16,165 ) |
| Increase (decrease) in %           | 3.57 % | (49.64 )% | (17.01 )% |

Coke products include finished coke (a key raw material for producing steel), coke powder (a smaller-grained coke that can be produced along with coke and used by non-ferrous metallurgical industry), coal tar, and crude benzol. Coal tar and crude benzol are byproducts of the coke manufacturing process with various industrial applications.

Coal products include unprocessed metallurgical coal, processed or washed coal, mid-coal and coal slurries, which are by-products of the coal washing process and used primarily to generate electricity and for heating. As used in this discussion and analysis, unless otherwise indicated, “coke” includes both coke and coke powder, and “raw coal” includes coal that is unwashed and relatively unprocessed, as well as mid-coal and coal slurries.

Average selling prices per metric ton of our products are as follows for the periods indicated:

**Average Selling Price of Coke Products**

|                                       | Coke     | Coal tar | Crude benzol | Coke powder |
|---------------------------------------|----------|----------|--------------|-------------|
| Three months ended September 30, 2013 | \$220    | \$ 314   | \$345        | \$ 172      |
| Three months ended September 30, 2014 | 191      | 319      | 1,041        | N/A         |
| Increase (decrease) in \$             | \$(29 )  | \$ 5     | \$696        | \$ N/A      |
| Increase (decrease) in %              | (13.18)% | 1.59 %   | 201.74%      | N/A         |

**Average Selling Price of Coal Products**

|                                       | Coal slurries | Mid-coal | Washed coal | Raw coal |
|---------------------------------------|---------------|----------|-------------|----------|
| Three months ended September 30, 2013 | \$41          | \$48     | \$166       | \$N/A    |
| Three months ended September 30, 2014 | 28            | 49       | 146         | N/A      |
| Increase (decrease) in \$             | \$(13 )       | \$1      | \$(20 )     | \$N/A    |
| Increase (decrease) in %              | (31.71)%      | 2.08%    | (12.05)%    | N/A      |

Generally, our selling prices are driven by a number of factors, including the particular composition and quality of the coal or coke we sell, their prevailing market prices locally and throughout China, as well as in the global marketplace, timing of sales, delivery terms, and our relationships with our customers and our negotiations of their purchase orders. Coke, coal slurries and washed coal selling prices decreased over the three months ended September 30, 2014 and 2013 and coal tar and mid-coal selling price increased over the three months ended September 30, 2014 and 2013.

However, the increase of \$696 or 201.74% at our crude benzol selling price over the three months ended September 30, 2014 and 2013 was due not only to the factors stated above, but also to our crude benzol production quality and quantity. We started to produce crude benzol using new coking ovens and technology in April 2013. As we gained more experience producing crude benzol, we produced more and higher quality crude benzol which gave us more bargaining power with our customers for higher selling prices.

The average price of coke was calculated based on the weighted average price of coke and coke powder. The average price of raw coal was calculated based on the weighted average price of unprocessed coal, coal byproducts and mixed thermal coal. We note that the average selling prices for coal products are also influenced by changes in the coal mixtures (with different grades and heat content) that we sell to our customers.



Revenue and quantity sold of each coke product are as follows for the periods indicated:

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**Coke Products**

|                                       | Coke         | Coal tar    | Crude benzol | Coke powder | Total        |
|---------------------------------------|--------------|-------------|--------------|-------------|--------------|
| <b>Revenue</b>                        |              |             |              |             |              |
| Three months ended September 30, 2013 | \$11,261,070 | \$605,348   | \$68,994     | \$840,709   | \$12,776,121 |
| Three months ended September 30, 2014 | 11,190,216   | 465,322     | 378,790      | -           | 12,034,328   |
| Increase in \$                        | \$(70,854 )  | \$(140,026) | \$309,796    | \$(840,709) | \$(741,793 ) |
| Increase in %                         | (0.63 )%     | (23.13 )%   | 449.02 %     | (100.00 )%  | (5.81 )%     |
| <b>Quantity sold (metric tons)</b>    |              |             |              |             |              |
| Three months ended September 30, 2013 | 51,261       | 1,929       | 200          | 4,884       | 58,274       |
| Three months ended September 30, 2014 | 58,535       | 1,458       | 364          | -           | 60,357       |
| Increase in metric tons               | 7,274        | (471 )      | 164          | (4,884 )    | 2,083        |
| Increase in %                         | 14.19 %      | (24.42 )%   | 82.00 %      | (100.00 )%  | 3.57 %       |

Coke revenues decreased 0.63%, resulting from a 14.19% increase of coke quantity by weight, offset by an average coke price decrease of 13.18%. Due to the market price of and demand for our coke products, we did not produce or sell any coke powder in the three months ended September 30, 2014. Coal tar byproduct revenues decreased by 23.13%, while crude benzol revenues increased by 449.02%. The increase in crude benzol products resulted from an 82.00% increase in the quantity by weight sold and a 201.74% increase in average selling price.

Because the market demand of coke is still weak, we believe coke product revenues will not recover unless we can contract with special customers such as Fangda Steel or we can produce higher quality products for which market demand is strong, such as crude benzol and other byproducts.

Revenues and quantity of each coal product sold are as follows for the period indicated:

**Coal Product**

|                                       | Coal slurries | Mid-coal  | Washed coal | Total       |
|---------------------------------------|---------------|-----------|-------------|-------------|
| <b>Revenue</b>                        |               |           |             |             |
| Three months ended September 30, 2013 | \$158,471     | \$375,608 | \$4,165,770 | \$4,699,849 |
| Three months ended September 30, 2014 | 101,954       | 362,264   | 1,075,290   | 1,539,508   |

|                |             |             |               |               |
|----------------|-------------|-------------|---------------|---------------|
| Increase in \$ | \$(56,517 ) | \$(13,344 ) | \$(3,090,480) | \$(3,160,341) |
| Increase in %  | (35.66 )%   | (3.55 )%    | (74.19 )%     | (67.24 )%     |

**Quantity sold (metric tons)**

|                                       |          |          |           |           |
|---------------------------------------|----------|----------|-----------|-----------|
| Three months ended September 30, 2013 | 3,828    | 7,777    | 25,158    | 36,763    |
| Three months ended September 30, 2014 | 3,674    | 7,460    | 7,381     | 18,515    |
| Increase in metric tons               | (154 )   | (317 )   | (17,777 ) | (18,248 ) |
| Increase in %                         | (4.02 )% | (4.08 )% | (70.66 )% | (49.64 )% |

Our coal revenues continued to suffer from raw coal supply from our coal mine created by the ongoing mining moratorium. We cannot anticipate whether or when the moratorium will end. We received no raw coal revenues for the three months ended September 30, 2014 and 2013.

Because we cannot produce raw coal on our own, we purchase raw coal from third parties and wash coal for our coking processing. In response to the higher price of raw coal used to make washed coal, we have adapted our coal washing process to increase washed coal yield. Doing so has also resulted in less mid-coal and coal slurries being produced, which when combined with the effect of selling price changes, resulted in revenue decreases for both mid-coal and coal slurries.

Our lower washed coal revenue for the three months ended September 30, 2014 resulted from the limited amount of washed coal sold to our customers due to the limited availability of raw coal with which to produce washed coal. In addition, the quarter saw the continued deterioration in the per-ton price of such products, a trend we have seen in recent quarters.

#### Cost of Revenue

Cost of revenue decreased by 21.46%, from \$14,378,669 to \$11,292,494 compared to the same period last year. This was mainly driven by lower sales volumes for most of our products and coal tar and coke powder, and the cheaper cost of obtaining raw coal, as compared to the same period of last year.

#### Gross Profit

Gross profit was \$2,281,342, a decrease of \$815,959 or 26.34% from \$3,097,301 for the same period of 2013, mainly because coke prices declined and sales of washed coal dropped. Despite total sales decreases as stated above, gross profit margin remained stable at 16.81% compare to 17.72% in the same period of last year, mainly due to higher profit margins of certain coke products, such as crude benzol.

#### Operating Expenses

Operating expenses, which consist of selling expenses and general and administrative expenses, were \$921,959, an increase of \$277,504 or 43.06% from \$644,455 in the same period of 2013. Selling expenses decreased by \$6,710, or 16.42%, to \$34,164, from a slight reduction in expenses relating to selling activities. General and administrative expenses increased by \$284,214 or 47.09%, to \$887,795, due to: (1) an increase of \$120,000 in our payroll, and (2) an increase in bad debt expense for doubtful accounts of \$116,359.

Other Income and Expense

Other income and expense includes finance expense (which consists of interest and other finance expenses, net of interest income), income and expense not related to our principal operations, and change in fair value of warrants. Finance expense was \$1,395,625, an increase of \$737,408 or 112.03% from the same period a year ago. This is largely due to the following: (1) we incurred an additional \$718,446 in interest expense in connection with extending Hongli's loan with Bairui Trust Co., Ltd. ("Bairui Trust"), due to an average interest rate increase from 6.2% to 11.8%; (2) bank service charges decreased by \$61,880, or 98.94%, for the same period of a year ago as our banking transactions decreased, and (3) interest income from loans receivable decreased by \$80,842, because we collected \$4.5 million in principal during August 2014.

We also recorded other expenses from the change of fair value of warrants in the amount of \$2,027,162 for the three months ended September 30, 2014 compared to other income of \$12 in the same period of last year, mainly as a result of the increased volatility of our stock price during the three months ended September 30, 2014 and newly issued warrants and options related to the September 24, 2014 Security Purchase Agreement, pursuant to which we issued 2,818,845 shares of common stock attached with Series A warrants to purchase an aggregate of 1,409,423 common shares and Series B warrants to purchase an aggregate of 1,644,737 common shares.

As a result of the foregoing, we had other expense of \$3,422,787 for three months ended September 30, 2014 as compared other expense of \$658,205 for the same period of 2013.

Provision for Income Taxes

Provision for income taxes over the three months ended September 30, 2014 decreased by \$143,904 to \$489,853 from the same period a year ago, reflecting our lower taxable income.

Net income (loss)

We recorded a net loss of \$2,553,257, including the increase in fair value of warrants of \$2,027,162 for the three months ended September 30, 2014, as compared to net income of \$1,160,884 for the same period a year ago.

**Liquidity and Capital Resources**

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations and otherwise operate on an ongoing basis. At September 30, 2014 our working capital was \$8,792,853 as compared to \$6,760,391 at June 30, 2014, reflecting the \$13.2 million capital contribution from a private placement concluded during the three months ended September 30, 2014, \$7 million investment in our underground gasification construction, and an increase from the current portion of warrants liability of \$4 million.

In summary, our cash flows for the quarters ended September 30, 2014 and 2013 are as follows:

|   | For the three months ended September 30, |               |
|---|--|---------------|
|   | 2014                                     | 2013          |
| Net cash used in operating activities     | \$ (1,384,668                            | ) \$ (565,804 |
| Net cash used in investing activities     | \$ (2,526,661                            | ) \$ -        |
| Net cash provided by financing activities | \$ 15,220,921                            | \$ -          |

*Net Cash Used in Operating Activities*

Net cash used in operating activities for the three months ended September 30, 2014 was approximately \$1.38 million as compared to net cash used in operating activities of approximately \$0.56 million for the same period last year. Except for \$2,448,560 in non-cash adjustments, such as \$279,032 in depreciation, \$17,674 in amortization and

depletion, \$116,359 in bad debt allowance and \$2,027,162 in change in fair value of warrants which increased our derivative liabilities as well as the relevant losses from this valuation, net operating inflow for the three months ended September 30, 2014 resulted from the following factors: (1) inventories decreased by \$3,224,546 as our grant of an increased credit line to two new customers enabled them to purchase more of our products, thereby reducing inventory; (2) advances to suppliers decreased by \$263,038, due to greater control of our prepayment policy; (3) our taxes payable increased by \$925,584 due to VAT payable, which was paid in October 2014. Cash inflow was mainly offset as follows: (1) our accounts receivable increased by \$2,641,476, due to Hongli's extension of an increased credit line to its two new customers during the period; (2) accounts payable decreased by \$2,303,148, mainly due to lower raw material purchases during the period; and (3) other payables and accrued liabilities decreased by \$675,686 due to the payment of interest related to Bairui Trust over the period.

Net cash used in operating activities for the three months ended September 30, 2013 was approximately \$0.57 million, including the non-cash adjustments of \$280,236 in depreciation, \$17,659 in amortization and depletion and \$85,938 in write-off other receivables and advances to suppliers. Net operating inflow also resulted from: (1) inventories decreased \$753,639 due to the increase of coke sales (in particular, crude benzol sales), and (2) increase of accounts payable of \$194,299. Cash inflow was mainly offset as follows: (1) other receivables increased by \$1,333,864 due to an additional deposit of \$1,637,000 to bid at an auction for some non-performing assets, including certain mining rights subject to the ongoing mine consolidation program, valued collectively at \$19.5 million (RMB 120 million). Should Hongli win the auction, the deposit would be applied against Hongli's bid price for the assets. Otherwise, PRCCU would refund the deposit back to Hongli before December 31, 2013. On December 30, 2013, the parties entered into a supplemental agreement to postpone the auction date and to extend the deposit refund date to December 31, 2014. As of September 30, 2013, the total deposit made for this auction was \$3,256,000; (2) other payables and accrued liabilities decreased by approximately \$1.1 million due to the payment of interest of \$852,030 to Bairui Trust and service charge payments of \$226,000 for compensation payable to the our Chief Executive Officer and Chief Financial Officer.

*Net Cash Used in Investing Activities*

Net cash used in investing activities for three months ended September 30, 2014 was approximately \$2.5 million. We collected loans receivable of \$4.5 million from Capital Paradise Limited (“CPL”) and invested \$7,026,661 in underground gasification construction.

For the three months ended September 30, 2013, we had no cash flows from investing activities.

*Net Cash Provided by Financing Activities*

Net cash provided by financing activities was approximately \$15.2 million. During the three months ended September 30, 2014, we completed a registered sale of 2,818,845 shares of our common stock with net consideration of \$13.2 million and obtained additional loans from our shareholder and the CEO, Mr. Lv Jianhua, of approximately \$2.0 million. Such loans have not been reduced to writing but are made without interest and are payable on demand.

For the three months ended September 2013, we had no cash flows from financing activities.

*Capital Resources*

Funding for our business activities has historically been provided by cash flow from operations, short-term bank loan financing, and loans from our Chairman.

On April 2, 2011, Hongli entered into a loan agreement with Bairui Trust, pursuant to which Bairui Trust agreed to loan Hongli RMB 360 million (approximately \$57.06 million), of which RMB 180 million was due on April 2, 2013, and RMB 180 million on April 2, 2014, with an annual interest rate of 6.3%. Bairui Trust made the loan to Hongli on April 3, 2011. On November 30, 2011, Hongli entered into a supplemental agreement with Bairui Trust to amend the terms such that RMB 30 million (approximately \$4.8 million) would be due on October 2, 2012, RMB 100 million (approximately \$15.8 million) on April 2, 2013, RMB 50 million (approximately \$7.9 million) on October 2, 2013, and RMB 180 million (approximately \$28.5 million) on April 2, 2014. We made the October 2, 2012 payment on December 25, 2012, including outstanding interest charge for late payment. We repaid \$3.2 million (RMB 20 million) on April 3, 2013, and entered into another supplemental agreement with Bairui Trust on April 23, 2013 to extend the due date for the remaining \$12.7 million (RMB 80 million). Of such remaining principal, the due date for \$3.2 million



(RMB 20 million) has been extended to December 2, 2013 with an annual interest rate of 6.3% starting from April 23, 2013. The due date for \$4.8 million (RMB 30 million) has been extended to January 2, 2014 with an annual interest rate of 6.3% starting from April 23, 2013. The due date for \$4.8 million (RMB 30 million) has been extended to February 2, 2014 with an annual interest rate of 6.3% starting from April 23, 2013. Between April 3, 2013 and April 23, 2013, Bairui Trust charged a 9.45% annual interest rate on the entire \$12.7 million outstanding.

On October 1, 2013, the parties executed an extension agreement, for the remaining balance of approximately \$50.7 million (RMB 310 million) with 9.9% interest rate as follows:

| Loan Amount<br>(in USD) | Loan Amount<br>(in RMB) | Extended Loan<br>Repayment Date | New Interest Rate Period               |
|-------------------------|-------------------------|---------------------------------|--|
| \$ 8,185,000            | ¥ 50,000,000            | October 2, 2016                 | October 3, 2013 – October<br>2, 2016   |
| 3,274,000               | 20,000,000              | December 2, 2016                | December 3, 2013 –<br>December 2, 2016 |
| 4,911,000               | 30,000,000              | January 2, 2017                 | January 3, 2014 – January<br>2, 2017   |
| 4,911,000               | 30,000,000              | February 2, 2017                | February 3, 2014 –<br>February 2, 2017 |
| 29,466,000              | 180,000,000             | April 2, 2017                   | April 3, 2014 – April 2,<br>2017       |
| \$ 50,747,000           | ¥ 310,000,000           |                                 |  |

On April 2, 2014, the parties entered into another supplement agreement, which replaced the extension agreement dated October 1, 2013, as follows:

| Loan Amount<br>(in USD) | Loan Amount<br>(in RMB) | Extended Loan<br>Repayment Date | New Interest Rate Period        |
|-------------------------|-------------------------|---------------------------------|---------------------------------|
| \$ 3,245,752            | ¥18,000,000             | April 2, 2015                   | December 3, 2013 – April 2,2015 |
| 4,868,628               | 30,000,000              | April 2, 2015                   | January 3, 2014 – April 2,2015  |
| 4,868,628               | 30,000,000              | April 2, 2015                   | February 3, 2014 – April 2,2015 |
| 8,114,380               | 50,000,000              | January 2, 2015                 | October 3, 2013 –January 2,2015 |
| 29,211,770              | 180,000,000             | October 2, 2015                 | April 3, 2014 – October 2, 2015 |
| \$ 50,309,158           | ¥308,000,000            |                                 |                                 |

According to the new supplement agreement, the annual interest rate was changed from 9.9% to 11.88% and, for the period between December 3, 2013 and April 2, 2014, Bairui Trust charged an additional 7.2% annual interest rate on \$12.9 million (RMB 80 million) of the outstanding \$50.3 million (RMB 310 million) loan principal. We paid back Bairui Trust RMB 2,000,000 in April 2014 after the supplemental agreement.

We intend to negotiate with Bairui Trust to further extend the maturity dates by an additional two to three years, and to repay the loan through our operational cash flow. We have no guaranty that we will ultimately be successful with such negotiations or the final terms of such negotiations in the event we are successful.

Our business plan involves growing our business through:

- (1) Expand production capability of higher margin coke products such as crude benzol and other derivative byproducts in order to hedge against the unfavorable market conditions for coal and coke that we are facing;

Look for opportunities to build long-term relationship with quality coal producers to ensure our supply. To that end, Shenhua Group is already supplying us under a tripartite agreement with Shenhua Group and Fangda Steel.

- (2) Under such arrangement, we do not need to make any prepayments or purchase inventory until all coke products ordered by Fangda Steel are delivered, and our receivables from Fangda Steel are settled. As such, we can increase coke sales without significant demand on our working capital;

Develop and install the system of green facility for the conversion of carbon dioxide into a clean-burning synthetic gas (syngas) to expand our product into the high margin product of syngas. Syngas, a clean-burning fuel, is increasingly utilized as a clean-energy alternative to burning coal. Comprised primarily of hydrogen and carbon monoxide, syngas can also be used to produce a range of widely-used industrial products such as fertilizers, solvents and assorted synthetic materials. This coke gasification facility project was completed and turned to commissioning and trial production stage as the filling of the report.

- (3)

The following is expected to require capital resources:

*New Coking Facility.* We intend to use existing cash, cash flow from operations, bank loans, collection of our loan receivables, along with other finance arrangements such as extending our long-term loan from Bairui Trust, to complete the construction of our new coking facility. Due to ongoing market conditions, however, we have once again slowed down construction, but plan to resume at full pace if and when market conditions improve.

*Coal Mine Safety Improvement Project.* The total estimated cost for government-mandated safety upgrades is approximately \$31.5 million. We will be responsible for approximately 70% of the total estimated cost, approximately \$22.0 million, under the structure of our joint venture with Henan Coal Seam Gas. These projects have not commenced as of the date of this Report, and we are not sure when it will commence at this time.

*Coal Underground Gasification Project.* On August 28, 2014, we entered in a cooperative agreement with North China Institute of Science and Technology for an underground coal gasification development project to refine and implement technology designed to convert our coal mines with 2.3 million tons of coal recovery reserves into syngas. During the first stage, we plan to invest \$18 million in building an underground coal gasification facility.

### **Off-balance Sheet Arrangements**

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. Other than warrants liability, we have not entered into any derivative contracts that are indexed to its shares and classified as shareholder's equity or that are not reflected in its consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or that engages in leasing, hedging or research and development services with us.

### **Critical Accounting Policies**

Our management's discussion and analysis of our financial condition and results of operations are based on our financial statements that have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported net sales and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

While our significant accounting policies are described in Note 2 to our financial statements elsewhere in this Report, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating this management discussion and analysis:

#### Revenue recognition

We recognize revenue from the sale of coal and coke, our principal products, at the date of shipment to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations on our part exist and collectability is reasonably assured. This generally occurs when coal or coke is loaded onto trains or trucks at one of our loading facilities or at third-party facilities. Accordingly, management is required to apply its own judgment regarding collectability based on its experience and knowledge of its current customers, and thus exercise a certain degree of discretion.

Most, if not all, of the electricity generated by Hongguang Power is typically used internally by Baofeng Coking. Supply of surplus electricity generated by Hongguang Power to the national power grid is mandated by the local utilities board. The value of the surplus electricity supplied, if it exists, is calculated based on actual kilowatt-hours produced and transmitted and at a fixed rate determined under contract.

Coal and coke sales represent the invoiced value of goods, net of a value-added tax (“VAT”), sales discounts and actual returns at the time when product is sold to the customer.

Accounts receivables, trade

During the normal course of business, we extend unsecured credit not exceeding three months to our customers. Management regularly reviews aging of receivables and changes in payment trends by its customers, and records allowance when management believes collection of amounts due are at risk. Accounts receivables are considered past due after three months from the date credit was granted. Accounts considered uncollectible after exhaustive efforts to collect are written off. We regularly review the credit worthiness of our customers and, based on the results of such credit review, determine whether extended payment terms can be granted to or, in some cases, partial prepayment is required from certain customers. As of September 30, 2014 and June 30, 2014, \$286,030 and \$140,158 allowance for doubtful accounts was provided, respectively.

#### Intangible assets - mining rights, net

Mining rights are capitalized at fair value when acquired, including amounts associated with any value beyond proven and probable reserves, and amortized to operations as depletion expense using the units-of-production method over the estimated proven and probable recoverable tons. Our coal reserves are controlled through direct ownership by our VIEs which generally last until the recoverable reserves are depleted.

#### Long-term investment

Entities in which we have the ability to exercise significant influence, but do not have a controlling interest, are accounted for under the equity method. Significant influence is generally considered to exist when we have between 20% and 50% of ownership interest in the voting stock, but other factors, such as representation on the board of directors, voting rights and the impact of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate.

#### Impairment of long-lived assets

We evaluate long-lived tangible and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows, in accordance with the accounting guidance regarding “Disposal of Long-Lived Assets.” Recoverability is measured by comparing an asset’s carrying value to the related projected undiscounted cash flows generated by the long-lived asset or asset group, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. When the carrying value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss to the extent that the carrying value exceeds its fair value. As of September 30, 2014, there was no impairment of long-lived assets. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and/or third party independent appraisals.

#### Recently issued accounting pronouncements

In July 2013, the FASB issued Accounting Standards Update 2013-11, “Income Taxes (Topic 740)—Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU 2013-11”). The objective of ASU 2013-11 is to eliminate diversity in practice of presenting unrecognized tax benefits as a liability or presenting unrecognized tax benefits as a reduction of a deferred tax asset

for a net operating loss or tax credit carryforward in certain circumstances by requiring that an unrecognized tax benefit be presented in the financial statements as a reduction to deferred tax assets excluding certain exceptions. ASU 2013-11 will be effective prospectively for the Company in its first quarter of 2014. The Company does not expect ASU 2013-11 to have a material effect on its financial statements.

In April 2014, the Financial Accounting Standards Board (the “FASB”) issued an accounting standard that raises the threshold for disposals to qualify as discontinued operations and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The standard revised the definition of a discontinued operation to cover only asset disposals that are considered to be a strategic shift with a major impact on an entity's operations and finances, such as the disposal of a major geographic area or a significant line of business. Application of the standard, which is to be applied prospectively, is required for fiscal years beginning on or after December 15, 2014, and for interim periods within that year. The Company currently plans to adopt the standard in January 2015.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-9, “Revenue from Contracts with Customers” (“ASU 2014-9”). ASU 2014-9 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The updated guidance related to revenue recognition which affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for us starting on January 1, 2017. We are currently evaluating the impact this guidance will have on our combined financial position, results of operations and cash flows.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **General**

We do not use derivative financial instruments and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, trade accounts receivable, accounts payable and long-term obligations. We generally consider investments in highly liquid instruments purchased with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents.

#### **Currency Fluctuations and Foreign Currency Risk**

Substantially all of our operations are conducted in China. All of our sales and purchases are conducted within China in RMB, which is the official currency of China. As a result, the effect of the fluctuations of exchange rates is considered minimal to our business operations.

Substantially all of our revenues and expenses are denominated in RMB. However, we use the United States dollar for financial reporting purposes. Conversion of RMB into foreign currencies is regulated by the People's Bank of China through a unified floating exchange rate system. Although the PRC government has stated its intention to support the value of RMB, there can be no assurance that such exchange rate will not again become volatile or that RMB will not devalue significantly against the U.S. dollar. Exchange rate fluctuations may adversely affect the value, in U.S. dollar terms, of our net assets and income derived from our operations in China.



### **Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our short-term and long-term obligations. Accordingly, fluctuations in applicable interest rates would not have a material impact on the fair value of these securities. At September 30, 2014, we had approximately \$11.58 million in cash. A hypothetical 2% increase or decrease in applicable interest rates would not have a material impact on our earnings or loss, or the fair market value or cash flows of these instruments.

### **Commodity Price Risk**

Although we are endeavoring to expand our business into clean energy, our business is currently affected by prevailing market prices for coal and coke. However, we do not currently engage in any hedging activities, such as futures, forwards, or options contracts, with respect to any of our inputs or products.

### **Credit Risk**

We are exposed to credit risk from our cash at bank and fixed deposits and accounts receivable. The credit risk on cash at bank and fixed deposits is limited because the counterparties are recognized financial institutions. Accounts receivable are subjected to credit evaluations. An allowance has been made for estimated irrecoverable amounts which have been determined by reference to past default experience and the current economic environment.

## **Inflation**

Inflationary factors, such as increases in the cost of our products and overhead costs, could impair our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of sales revenue if the selling prices of our products do not increase with these increased costs.

## **Company's Operations are Substantially in Foreign Countries**

Substantially all of our operations are conducted in China and are subject to various political, economic, and other risks and uncertainties inherent in conducting business in China. Among other risks, our operations are subject to the risks of restrictions on transfer of funds; export duties, quotas, and embargoes; domestic and international customs and tariffs; changing taxation policies; foreign exchange restrictions; and political conditions and governmental regulations. Additional information regarding such risks can be found under the heading "*Risk Factors*" in this Report.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **(a) Evaluation of Controls and Procedures**

Regulations under the Securities Exchange Act of 1934 (the "Exchange Act") require public companies to maintain "disclosure controls and procedures," which are defined as controls and other procedures that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We conducted an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of September 30, 2014. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2014, our disclosure controls and procedures were ineffective.

**(b) Changes in Internal Control over Financial Reporting**

There were no changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

None

**ITEM 1A. RISK FACTORS.**

There have been no material changes to the Company's risk factors which are included and described in our Annual Report. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

On September 11, 2014, we issued 20,000 unregistered shares of our common stock to Perceptive Programs, LLC, which serves as our investor relations firm. The shares are issued in return for services to be performed pursuant to an agreement for the period August 1, 2014 through July 31, 2015. No underwriters were involved in the issuance. The issuance was completed in reliance on Section 4(a)(2) of the Securities Act of 1933.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

The disclosures required by Item 4 are not applicable to our operations, as the Company has no mining operations in the United States.

**ITEM 5. OTHER INFORMATION.**

None

**ITEM 6. EXHIBITS**

| Exhibit<br>Number | Description  |
|-------------------|--|
| 3.1               | Articles of Incorporation, as amended (1)  |
| 3.2               | Articles of Amendment to Articles of Incorporation (2)   |
| 3.3               | Bylaws (1)   |
| 10.1              | Fourth Supplemental Agreement to Loan Agreement among Bairui Trust Co., Ltd., Henan Province Pingdingshan Hongli Coal & Coke Co., Ltd., Pingdingshan Hongyuan Energy Science and Technology Development Co., Ltd., and Jianhua Lv, dated April 3, 2014 (3) |
| 31.1              | Certification pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *   |
| 31.2              |  |

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Certification pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*

- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*
- 99.1 Press release dated November 14, 2014 \*

101.INS XBRL Instance Document \*

101.SCH XBRL Taxonomy Extension Schema Document \*

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document\*

101.DEF XBRL Taxonomy Extension Definition Linkbase Document\*

101.LAB XBRL Taxonomy Extension Label Linkbase Document\*

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document\*

\* Filed herewith.

(1) Incorporated by reference to the Form 10-SB filed by the Company with the Securities and Exchange Commission on November 18, 1999.

- (2) Incorporated by reference to the Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on February 8, 2011.
- (3) Incorporated by reference to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 filed by the Company with the SEC on May 23, 2014.

## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**SINOCOKING COAL AND COKE  
CHEMICAL  
INDUSTRIES, INC.**

Dated: November 14, 2014 By: /s/ Jianhua Lv  
Jianhua Lv  
Chief Executive Officer  
(Principal Executive Officer)

Dated: November 14, 2014 By: /s/ Song Lv  
Song Lv  
Chief Financial Officer  
(Principal Financial and Accounting Officer)