

Recon Technology, Ltd  
Form 10-Q  
February 11, 2010  
Table of Contents

# U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

## FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended December 31, 2009

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

Commission File Number 001-34409

## RECON TECHNOLOGY, LTD

(Exact name of registrant as specified in its charter)

Cayman Islands

Not Applicable

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(State or other jurisdiction of incorporation or organization) **Room 1902, Building C, King Long International Mansion** (I.R.S. employer identification number)

**No. 9 Fulin Road, Beijing, 100107**

**People's Republic of China**

(Address of principal executive offices and zip code)

**0086-010-84945799**

(Registrant's telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The Company is authorized to issue 25,000,000 Shares. As of the date of this report, the Company has issued and outstanding 3,951,811 Shares.

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**FORM 10-Q**

**INDEX**

|  |    |
|--|----|
| <u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>   | ii |
| <b>PART I</b> <u>FINANCIAL INFORMATION</u>   | 1  |
| Item 1. <u>Financial Statements</u>  | 1  |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 1  |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>                            | 14 |
| Item 4/4T. <u>Controls and Procedures</u>  | 14 |
| <b>PART II</b> <u>OTHER INFORMATION</u>  | 15 |
| Item 1. <u>Legal Proceedings</u>   | 15 |
| Item 1A <u>Risk Factors</u>  | 15 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 15 |
| Item 3. <u>Defaults upon Senior Securities</u>   | 15 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u>                                   | 15 |
| Item 5. <u>Other Information</u>   | 15 |
| Item 6. <u>Exhibits</u>  | 16 |

**Table of Contents**

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

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

the timing of the development of future products;

projections of revenue, earnings, capital structure and other financial items;

statements of our plans and objectives;

statements regarding the capabilities of our business operations;

statements of expected future economic performance;

statements regarding competition in our market; and

assumptions underlying statements regarding us or our business.

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

**Table of Contents**

**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

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

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

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

***Overview***

We are a company focused on production and service for oil field exploitation industry companies in the People's Republic of China. Through our contractual relationships with Beijing BHD Petroleum Technology Co., Ltd. ( BHD ), Nanjing Recon Technology Co., Ltd. ( Nanjing Recon ), and Jining ENI Energy Technology Co., Ltd. ( ENI and, together with BHD and Nanjing Recon, the Domestic Companies ), we provide equipment, tools and other hardware related to oil field production and management and develop and sell our own specialized industrial automation control and information solutions. However, we do not engage in the production of petroleum or petroleum products.

Following our initial public offering and listing on the NASDAQ Capital Market, our business continued to grow due to our efforts to optimize our product portfolio and expand into new business areas. For the six months ended December 31, 2009 and 2008, our total revenues amounted to \$10.6 million and \$7.3 million, respectively. We derive revenues from hardware sales and software service. For the six months ended December 31, 2009, approximately 91.46% of our revenues came from hardware sales, and approximately 8.54% came from software services. For the same period in 2008, hardware sales and software services constituted 95.88% and 4.12%, respectively, of our revenues.

Our management believes that Chinese oilfields will promote digitization management and stimulation measures in oil and gas wells in the future; as such we are placing a higher emphasis on these areas. To a certain extent, our change in revenue structure reflects this short-term strategy. Under this strategy, our business benefits from sales of high-tech products and software systems. Our management also believes the development and sales of software products facilitated the development of our hardware and service business. We expect our software service revenues to continue to grow, as our customers require continuing service associated with their software purchase. As a result, our management continues to seek to strengthen its competitive position in the oil field service industry by developing software products.

Our solutions and new technology enable our customers to reduce their expenditures and improve their integrated benefit by changing from manual to mechanized production methods. Our major clients, Sinopec and CNPC, are large oil and refinery firms formed following the Chinese government's decision to decentralize the oil and gas industry within China. Both companies are ranked in the Fortune 500. We aim to continue extending our market share in the short-term and to be a leading non-government-owned service provider to the oil field exploitation industry in the long-term. Our mission is to increase the automation and safety levels of industrial petroleum production in China, and improve the under-developed working process and management mode by using high-technology.

***Factors Affecting Our Business***

Industry Background. As a whole, the Chinese petroleum industry faces four primary challenges: (a) global competition; (b) environment and development; (c) configuration of petroleum resources; and (d) gradually

## **Table of Contents**

increased profit margins. Compared to developed countries, however, there are still certain lags in terms of modernized management levels in China. In particular, with the introduction of computer techniques over the last ten years, the degree of automation in foreign countries has reached a higher level, while China is still in the initial stage.

With deeper development of the oil-field industry, most oil-fields in China have entered the third stage of oil extraction. During this stage, oil well output decreases, water content increases, and costs are higher.

Through application of the automation system we provide, oil well head information such as indicator diagrams, current diagrams, oil pressure, oil temperature and the running status of oil wells, can be accurately passed on to management in real time. Management may see information in the clear human-machine interface and make analysis and decisions enabling the realization of remote controls over oil extraction wells such as auto delayed start-up of the oil extraction well after being switched on/off or intermittent extractions. The system can achieve failure protection and send timely alarms, for instance, the system is equipped with auto stop and alarms in the cases of blocking, breaking of oil extraction rods, and phase breaking to avoid the occurrence of major accidents. The measurement station can realize automatic measurement of liquid and gas and transfer the data to the central control room in real time. With this system, the oil well heads and measurement stations have no need to be monitored by personnel and in addition, in-time and accurate information transfers between the oil extraction well and management have improved labor productivity, brought down manual work and consumptions, lowered costs for oil extractions, eliminated failures in time, increased oil output, actualized automatic management for oil fields and integrated management above and under-ground. The automation system also provides full and accurate data for research and development of petroleum deposit projects as well as a reliable technical basis for oil field productions and decision-making.

Our automation system can also be used in connection with the delivery of liquefied natural gas. China is currently diversifying its energy sources, and China imported 15% more liquefied natural gas in 2008 than in 2007. Although the increase from 2.9 to 3.3 million tons for the full year was significant, our optimism about the future of liquefied natural gas in China (as well as the need for our services in the industry) is tempered by a 23% drop from November to December 2008, which coincided with the international market crisis.

Apart from the above-mentioned factors, increasingly intense competition in the oil field market, increasing efficiency by reducing redundant staff and reduction of cost is bound to facilitate the all-around generalization of the automation system.

Accordingly, any significant change in the general demand for oil and liquefied natural gas in China, the PRC government's policy or the strategies of major PRC energy companies may significantly affect the demand for our service and products and, as a result, our revenues and financial condition.

In addition, our oil well water finding/blocking technology, multipurpose fissure shaper, and high-efficiency heating furnace can increase the oil field output, decrease the water content, save energy, lower consumption, reduce the oil extraction cost, and strengthen the competitive force of the domestic oil fields.

**Relevant Industry-Wide Trends.** Management believes the Chinese oil field service industry is likely to experience rapid growth in the near future. This belief is based on management's experience in the industry and its analysis of the following recent trends:

Management believes that larger companies in China are becoming more sophisticated in managing and implementing their information systems. Management believes that these tendencies are likely to create a strong demand for software integration and customized system development from these larger companies. As a result, management believes that many oil field service providers will attempt to reposition their businesses as development services providers, rather than off-the-rack vendors. In the context of economic transformation, local manufacturers will likely face industrial restructuring as they try to grow to compete and fend off increased pressure from greatly shortened product lives. Management believes that the use of advanced information technologies in management and control of manufacture is becoming more important to success in the market.

## **Table of Contents**

Management believes that a significant number of Chinese manufactures, especially those in the oil and gas industry, still lack sufficient technical applications and services for their needs. These companies tend to be more cost-sensitive. Management believes that such clients would be more likely to use our service and products to reduce expenses by third-parties like us. Management believes this will be an increasingly competitive market.

Management also believes that high-tech and precise instruments will become increasingly prevalent in the oil field service market, as China continues to be more dependent on oil and as oil resources continue to decline.

**Dependence on CNPC and Sinopec.** We derive substantially all of our revenues from the operating subsidiaries of two customers, (i) CNPC and (ii) Sinopec. In order to grow and to protect our company against the risks associated with our dependence on CNPC and Sinopec, management intends to improve our service and expand our potential market. Management believes that a large number of Chinese petroleum companies are likely to require services and products such as those we provide.

**Nature of Operations.** Our technicians and solutions were developed with strong industrial expertise in the oil and gas industry. Products and services provided by us mainly include:

*RSCADA System.* RSCADA is an industrial computerized process control system for monitoring, managing and controlling oil field service extraction. RSCADA integrates the underground, ground and above-ground levels of the oil field service extraction industry. RSCADA connects the above-ground level central control room with the ground level relay station and the relay station with the underground bottom intelligent terminal using the 2.4G wireless frequency. RSCADA has received grants and awards from the State Ministry of Science and Technology and the city of Nanjing.

*Water System.* We have developed and implemented technology designed to find and block water content in oil field service. As China's extraction of oil has increased, the quantity of available oil has decreased and the water content in remaining oil has increased. In order to improve our efficiency and profitability in extraction, we have developed technology to reduce the amount of water in our extracted oil field service.

*Oil Field Furnaces.* Crude oil field service contains certain impurities that must be removed before the oil field service can be sold, including water and natural gas. To remove the impurities and to prevent solidification and blockage in transport pipes, companies employ heating furnaces. We have researched, developed and implemented a new oil field furnace that is advanced, highly automated, reliable, easily operable, and comparatively safe and highly heat efficient (90% efficiency).

*Multipurpose Fissure Shaper.* We have also developed a multipurpose fissure shaper to improve our ability to test for and extract oil field service. Before any oil field service extractor can test for the presence of oil, it must first perforate a hole for testing. The depth of the perforated hole is, of course, extremely important in the testing process: a hole that is too shallow may cause an extractor to miss an oil field entirely. We have developed a proprietary multipurpose fissure shaper that is used with the perforating gun to effectively increase the perforation depth by between 46 and 80%, shape a great number of stratum fissures, improve the stratum diversion capability and, as a result, improve our ability to locate oil fields and increase the output of oil wells.

As a technology development company, we put a priority on research, exploration, design and innovation. For years we have been increasing investments in attracting and training talents to continually improve our research and development capability. We currently have more than 90 employees, 80% of whom graduated from college. We also cooperate with the Oil Field Service & Geology Research Laboratory of Nanjing University.

### ***Factors Affecting Our Results of Operations Generally***

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

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

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

the procurement processes of our customers, especially those in the oil and gas industry;



**Table of Contents**

competition and related pricing pressure from other oil field service solution providers, especially those targeting the Chinese oil and gas industry;

the ongoing development of the oil field service market in China; and

inflation and other factors.

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

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

our revenue growth;

the proportion of our business dedicated to large companies;

our ability to successfully develop, introduce and market new solutions and services;

our ability to increase our revenues to businesses, both old customers and new in the Chinese oil and gas industry;

our ability to effectively manage our operating costs and expenses; and

our ability to effectively implement any targeted acquisitions and/or strategic alliances so as to provide efficient access to markets and industries in the Chinese oil and gas industry.

***Critical Accounting Policies and Estimates***

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

**Revenue Recognition.** We recognize revenue when it is realized and earned. We consider revenue realized or realizable and earned when (1) we have persuasive evidence of an arrangement, (2) delivery has occurred, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the client and the client has signed a completion and acceptance report, risk of loss has transferred to the client, client acceptance provisions have lapsed, or we have objective evidence that the criteria specified in client acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

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

*Services.* The Company provides services to improve software functions and system requirements on separated fixed-price contracts. Revenue is recognized on the completed contract method when acceptance is determined by a completion report signed by the customer. Deferred revenue represents unearned amounts billed to customers related to service agreements.

*Software.* The Company sells self-developed software. For software sales, the Company recognizes revenues in accordance with the provisions of Statement of Position No. 97-2 (ASC Topic 985-605), Software Revenue Recognition, and related interpretations. Revenue from software is recognized according to project contracts. Contract costs are accumulated during the periods of installation and testing.

**Table of Contents**

or commissioning. Usually this is short term. Profits are not recognized until completion of the contracts. Costs included in inventory as work in process include direct materials, labor and related expense. Corporate general and administrative expenses are charged to expense in the period they are incurred.

Revenues applicable to multiple-element fee arrangements are divided among the elements such as software, hardware and post-contract service using vendor-specific objective evidence of fair value. Such evidence consists of pricing of multiple elements when those same elements are sold as separate products or arrangements. Software maintenance for the first year and initial training are included in the purchase price of the software. Initial training is provided at the time of installation and is recognized as income as part of the price of the software since it is minimal in value. Maintenance is valued based on the fee schedule used by us for providing the regular level of maintenance service as sold to customers when renewing their maintenance contracts on a standalone basis. Maintenance revenue is included in the income statement under services and is recognized over the term of the agreement.

Fair Values of Financial Instruments. The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, advances to suppliers, trade accounts payable, accrued liabilities, advances from customer and notes payable approximate fair value because of the immediate or short-term maturity of these financial instruments.

Allowance for Doubtful Accounts. Trade receivables and other receivable accounts are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less a provision made for impairment of these receivables. Provisions are applied to trade and other receivables where events or change in circumstances indicate that the balance may not be collectible. The identification of doubtful debts requires the use of judgment and estimates of management. Our management must make estimates of the collectability of our accounts receivable. Management specifically analyzes accounts receivable, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our allowance for trade accounts receivable was ¥604,953 (\$88,570) and ¥995,488 (\$145,840) on June 30, 2009 and December 31, 2009 respectively. Our allowance for trade accounts receivable increase primarily because our trade accounts receivable increased, which increased the potential for doubtful accounts. However, the increase in the allowance was relatively low, because even though our business developed significantly, which caused a great increase of accounts receivable, most of the growth occurred between us and our large clients. Because these clients are state-owned companies, our management believes the possibility that these accounts receivable will be uncollectable is relatively low. If the financial condition of our clients were to deteriorate, resulting in their inability to make payments, an additional allowance might be required.

Property and Equipment. We record property and equipment at cost. We depreciate property and equipment on a straight-line basis over their estimated useful lives using the following annual rates:

|                        |           |
|------------------------|-----------|
| Motor Vehicles         | 10 years  |
| Office Equipment       | 2-5 years |
| Leasehold Improvements | 5 years   |

We expense maintenance and repair expenditures as they do not improve or extend an asset's productive life. These estimates are reasonably likely to change in the future since they are based upon matters that are highly uncertain such as general economic conditions, potential changes in technology and estimated cash flows from the use of these assets.

Gains or losses on sales or retirements are included in the consolidated statements of operations in the year of disposition. The balance of accumulated depreciation was ¥1,006,761 (\$147,398) and ¥993,029 (\$145,479) as of June 30, 2009 and December 31, 2009, respectively.

**Table of Contents**

|                                | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|--------------------------------|-------------------------|-------------------------------------|-------------------------------------|
|                                | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| Motor vehicles                 | ¥ 1,464,918             | ¥ 1,544,114                         | \$ 226,214                          |
| Office equipment and fixtures  | 779,257                 | 541,543                             | 79,336                              |
| Leasehold improvement          | 169,462                 | 276,938                             | 40,572                              |
| Total property and equipment   | 2,413,637               | 2,362,595                           | 346,122                             |
| Less: Accumulated depreciation | (1,006,761)             | (993,029)                           | (145,480)                           |
| Property and equipment, net    | ¥ 1,406,876             | ¥ 1,369,566                         | \$ 200,643                          |

**Software Development Costs.** We charge all of our development costs to research and development until we have established technological feasibility. We acknowledge technological feasibility of our software when a detailed program design has been completed, or upon the completion of a working model. Upon reaching technological feasibility, we capitalize additional software costs until the software is available for general release to customers. Although we have not established a budget or time table for software development, we anticipate the need to continue the development of our software products in the future and the cost could be significant. We believe that, as in the past, the costs of development will result in new products that will increase revenue and therefore justify costs. There is, however, a reasonable possibility that we may be unable to realize the carrying value of our software, and the amount not so realized may adversely affect our financial position, results of operation or liquidity in the future.

**Cost of Revenues.** Cost of revenues includes wages, materials, handling charges, and other expenses associated with manufactured products and service provided to customers; the cost of purchased raw materials such as steel products and chemical materials. We expect cost of revenues to grow as our revenues grow. It is possible that we could incur development costs with little revenue recognition, but based upon our past history, we expect our revenues to grow.

**Valuation of Long-Lived Assets.** We review the carrying values of our long-lived assets for impairment whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, we project undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, we reduce the carrying value of the long-lived asset, by the estimated excess of the carrying value over the projected discounted cash flows. In the past, we have not had to make significant adjustments to the carrying values of our long-lived assets, and we do not anticipate a need to do so in the future. However, circumstances could cause us to have to reduce the value of our capitalized software more rapidly than we have in the past if our revenues were to significantly decline. Estimated cash flows from the use of the long-lived assets are highly uncertain and therefore the estimation of the need to impair these assets is reasonably likely to change in the future. Should the economy or acceptance of our software change in the future, it is likely that our estimate of the future cash flows from the use of these assets will change by a material amount.

**Results of Operations***Three Months Ended December 31, 2009 Compared to Three Months Ended December 31, 2008*

Our historical reporting results are not necessarily indicative of the results to be expected for any future period.

**Revenues.** Our total revenues increased by approximately 26.90% or ¥10,615,787, from ¥39,458,307 (\$5,780,675) for the three months ended December 31, 2008 to ¥50,074,094 (\$7,335,896) for the three months ended December 31, 2009. The sales of our oil field furnaces drove our revenue growth. We believe our software and service business are likely to play a large role in future revenues. Most of the increase of revenue was a result of our cooperation with new clients.

We believe the worldwide economic crisis made companies, including our clients, more cautious about their finances and encouraged those companies to seek ways to reduce costs and maximize output by investing in

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**Table of Contents**

technological solutions that would enable them to improve revenues and reduce expenses. Because our solutions are designed to help oil companies operate more efficiently, our customers ordered more of our products and services. As a result, we were able to continue to grow in a very difficult year for industry. In addition, this increase also resulted directly from our growing relationships with CNPC and Sinopec.

Specifically, the Chinese government has attached great importance to the safety problems that exist in the Chinese energy industry by implementing numerous new projects and initiatives designed to increase safety and security in the Chinese energy industry. This replacement project is a Chinese reform project designed to eliminate hidden security dangers and develop key projects for saving energy and materials. As a result of the new policies, the Chinese government has increased spending to replace equipment with potential safety problems. As such, we have experienced increased sales and a greater demand for our maintenance services, which has increased our revenue. Additionally, as we have provided services to CNPC and Sinopec and our relationships have grown, they have chosen to continue to use our solutions. During the period ended December 31, 2009, substantially all of our revenues were generated through our business engagements with these companies operating subsidiaries. These significant engagements made it possible for us to improve our service quality, products popularity and adaptability for a very limited number of customers. Further, this long-term cooperation provides us more preferences for collecting receivables on time. We expect that our gross revenues will continue to increase over time as we:

expand the adoption of our solutions into other markets outside the Chinese oil and gas industry; and

introduce our solutions to businesses located outside of China.

**Cost of Revenues.** Our cost of revenues includes costs related to the design, implementation, delivery and maintenance of our software solutions and raw materials. We have set up service and maintenance centers in Xinjiang, Jidong, Qinghai district, and other locations which can provide our customers with technical consulting, repair and maintenance services. We purchase equipment based on each client's needs. Raw materials used to produce our hardware products consist largely of steel products and chemical products.

Our cost of revenues increased from ¥22,338,687 (\$3,272,636) in the three months ended December 31, 2008 to ¥25,396,611 (\$3,720,625) for the same period of 2009, an increase of ¥3,057,924 or 13.69%. As a percentage of revenues, our cost of revenues decreased from 56.61% in 2008 to 50.72% in 2009. Our focus on solutions with comparatively higher margins, such as our software and service solutions, allowed our cost of revenues to decrease as a percentage of revenues, even as our business grew.

**Gross Margin.** For the three months ended December 31, 2009, our gross margin increased to ¥24,677,484 (\$3,615,272) from ¥17,119,620 (\$2,508,039) for the same period in 2008, an increase of ¥7,557,864, or approximately 44.15%. For the three months ended December 31, 2009, our gross margin as a percentage of revenue increased to 49.28%, from 43.39% for the same period ended December 31, 2008. This increase in gross margin can be attributed primarily to the increase in sales volume to CNPC and Sinopec, combined with the development of our lower cost software and service business. During this period, the company achieved many new software contracts in Sichuan province of China and the JiDong oilfield.

**Expenses.**

**General and Administrative Expenses.** General and administrative expenses consist primarily of costs from our human resources organization, facilities costs, depreciation expenses, professional advisor fees, audit fees, options expenses and other expenses incurred in connection with general operations. General and administrative expenses increased 114.17%, or ¥1,876,566, from ¥1,643,679 (\$240,800) in the three months ended December 31, 2008 to ¥3,520,245 (\$515,719) for the same period of 2009. General and administrative expenses were 4.17% of total revenues in 2008 and 7.03% of total revenues in 2009. This percentage increase was primarily attributable to increases in our audit fees and expenses associated with our incentive share options.

**Selling and Distribution Expenses.** Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing organization; sales commissions; costs of our marketing programs, including public relations, advertising and trade shows; and an allocation of our facilities and depreciation expenses. Selling expenses increased by 48.21%, from ¥2,606,958 (\$381,921) for the three months ended December 31, 2008 to ¥3,863,886 (\$566,062) for the same period of 2009. This increase resulted primarily from our business expansion

**Table of Contents**

activities. Because of the rapid growth of sales of furnaces, sales commissions for such sales also increased quickly. As we continued to solidify our business relationships with other companies, we required extensive marketing efforts and incurred the costs associated therewith. At present, we are expanding our business in the Sichuan district and Tuha oilfield. In order to successfully increase the scope of our client base, we established new local offices in different areas of China. We expect that our selling expenses will correspondingly increase. Selling expenses were 6.61% of total revenues in the three months ended December 31, 2008 and 7.72% of total revenues in same period of 2009. As we increase the scope of our client base over the next several years, we expect to see our selling expenses as a percentage of revenue increase as a result, in part, of our expanded marketing efforts. We expect that our marketing efforts will require a period of time before resulting in additional sales.

**Income from Operations.** Income from operations was ¥17,293,353 (\$2,533,491) for the three months ended December 31, 2009, compared to ¥12,868,984 (\$1,885,317) for the same period of 2008, an increase of ¥4,424,369 (\$648,174) or 34.38%. This increase in income from operations can be attributed primarily to the increase in sales volume to CNPC and Sinopec.

**Subsidy Income.** We received grants from the local government. For the three months ended December 31, 2009, we received ¥1,131,709 (\$165,796) in subsidy income. These grants were given by the government to support local software companies' operation and research and development. Grants related to research and development projects are recognized as subsidy income in the consolidated statements of operations when related expenses are recorded. This income typically increases at the end of the year.

**Income Tax Expense.** Income taxes are provided based upon the liability method of accounting pursuant to SFAS No. 109 (ASC Topic 740), Accounting for Income Taxes. Under this approach, deferred income taxes are recorded to reflect the tax consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts. A valuation allowance is recorded against deferred tax assets if it is not likely that the asset will be realized. In June 2006, the Financial Accounting Standards Board issued Financial Interpretation No. 48 (ASC Topic 740), Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition classification, interest and penalties, accounting in interim periods, disclosure, and transition. The interpretation is effective for the fiscal years beginning after December 15, 2006. The adoption of this interpretation had no material effect on the Company's financial statements.

We have not been subject to any income taxes in the United States or the Cayman Islands. Enterprises doing business in the PRC are generally subject to federal (state) enterprise income tax at a rate of 30% and a local income tax at a rate of 3% before calendar year 2008 and subject to a rate of 25% after calendar year 2008; however, due to Nanjing Recon's location in a State Standard High Technology Development Zone, it was granted a certification of High Technology Enterprise and was taxed at a rate of 15% for taxable income generated and was 50% exempt from this income tax from 2005 to 2007. Due to ENI's designation as a Qualifying High Technology company, ENI is subject to a 25% earned income tax (EIT) rate. BHD also pays the statutory rate of 25%. We had minimal operations in jurisdictions other than the PRC. Income tax expense for three months ended December 31, 2008 and 2009 were ¥3,231,050 (\$473,352) and ¥4,414,087 (\$646,667), respectively. This resulted from our increased revenues from sales and our profitable operation. We expect that our effective EIT rate will vary, depending on which of our Domestic Companies generate greater revenues, as an increased percentage of revenues from ENI or BHD will result in our effective rate moving closer to BHD's and ENI's 25% rate and away from Nanjing Recon's 15% rate.

**Income from continuing operations.** As a result of the factors described above, income from continuing operations was ¥13,987,777 (\$2,049,221) for the three months ended December 31, 2009, an increase of ¥3,228,541 (\$472,984) or 30.01% over the same period of 2008.

**Net Income Available for Common Shareholders.** As a result of the factors described above, net income available for common shareholders was ¥12,554,153 (\$1,839,194) for the three months ended December 31, 2009, an increase of ¥2,979,929 (\$436,562) or 31.12% over the same period of 2008.

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## **Table of Contents**

*Six Months Ended December 31, 2009 Compared to Six Months Ended December 31, 2008*

Our historical reporting results are not necessarily indicative of the results to be expected for any future period.

**Revenues.** Our total revenues increased by approximately 45.89% or ¥22,820,809, from ¥49,724,883 (\$7,284,737) for the six months ended December 31, 2008 to ¥72,545,692 (\$10,628,004) for the six months ended December 31, 2009. The sales of our oil field furnaces drove our revenue growth. We believe our software and service business are likely to play a large role in future revenues. Most of the increase of revenue was a result of our cooperation with new clients.

**Cost of Revenues.** Our cost of revenues increased from ¥31,141,366 (\$4,562,236) in the six months ended December 31, 2008 to ¥41,469,158 (\$6,075,266) for the same period of 2009, an increase of ¥10,327,792 or 33.16%. As a percentage of revenues, our cost of revenues decreased from 62.63% in 2008 to 57.16% in 2009. Our focus on solutions with comparatively higher margins, such as our software and service solutions, allowed our cost of revenues to decrease as a percentage of revenues, even as our business grew. We expect this trend will continue, provided we are able to continue to grow our higher-margin solution revenues.

**Gross Margin.** For the six months ended December 31, 2009, our gross margin increased to ¥31,076,535 (\$4,552,738) from ¥18,583,517 (\$2,722,501) for the same period in 2008, an increase of ¥12,493,018, or approximately 67.23%. For the six months ended December 31, 2009, our gross margin as a percentage of revenue increased to 42.84%, from 37.37% for the same period ended December 31, 2008. This increase in gross margin can be attributed primarily to the increase in sales volume, combined with the development of our lower cost software and service business. During this period, the company achieved many new software contracts in Sichuan province of China. The growth of our market share and increase in average revenues per contract has made it possible for us to take advantage of economies of scale. We believe this increase in sales volume resulted, in part, from the Chinese government's policy of improving safety and security in the energy industry.

### ***Expenses.***

**General and Administrative Expenses.** General and administrative expenses increased 100.33%, or ¥3,238,285, from ¥3,227,615 (\$472,848) in the six months ended December 31, 2008 to ¥6,465,900 (\$947,260) for the same period of 2009. General and administrative expenses were 6.49% of total revenues in 2008 and 8.91% of total revenues in 2009. This percentage increase was primarily attributable to an increase in audit fees and expenses associated with our incentive share options.

**Selling and Distribution Expenses.** Selling expenses increased by 80.46%, from ¥3,337,674 (\$488,972) for the six months ended December 31, 2008 to ¥6,023,098 (\$882,389) for the same period of 2009. This increase resulted primarily from our business expansion activities. Because of the rapid growth of sales of furnaces, sales commissions for such sales also increased quickly. As we continued to solidify our business relationships with other companies, we required extensive marketing efforts and incurred the costs associated therewith. At present, we are expanding our business in Sichuan district and Tuha oilfield. In order to successfully increase the scope of our client base, we established new local offices in different areas of China. We expect that our selling expenses will correspondingly increase. Selling expenses were 6.71% of total revenues in the six months ended December 31, 2008 and 8.30% of total revenues in same period of 2009.

**Income from Operations.** Income from operations was ¥18,587,537 (\$2,723,090) for the six months ended December 31, 2009, compared to ¥12,018,229 (\$1,760,680) for the same period of 2008, an increase of ¥6,569,308 or 54.66%. This increase in income from operations can be attributed primarily to the increase in sales volume to CNPC and Sinopec. In spite of (i) the seasonality of our business, (ii) our historical performance in the first half of our fiscal year and (iii) the increase in expenses during the period, we recognized a significant increase in income from operations.

**Subsidy Income.** We received grants from the local government. For the six months ended December 31, 2009, we received ¥1,158,034 (\$169,653) in subsidy income. These grants were given by the government to support local software companies' operation and research and development. Grants related to research and development projects are recognized as subsidy income in the consolidated statements of operations when related expenses are recorded. This income typically increases at the end of the year.

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## **Table of Contents**

**Income Tax Expense.** Income tax expense for six months ended December 31, 2008 and 2009 were ¥3,251,109 (\$476,290) and ¥5,106,765 (\$748,145), respectively. This resulted from our increased revenues from sales and our profitable operation.

**Income from continuing operations.** As a result of the factors described above, income from continuing operations was ¥14,649,512 (\$2,146,166) for the six months ended December 31, 2009, an increase of ¥4,227,715 (\$619,364) or 40.57% over the same period of 2008.

**Discontinued Operations.** At the end of the fiscal year 2008, our Company completed the sale of Inner Mongolia Adar Energy Technology, Ltd. and Beijing Weigu Windows Co. which were both the majority-owned subsidiaries of BHD as well as Xiamen Recon Technology Development, Ltd., which was the majority-owned subsidiary of Nanjing Recon. In the fourth quarter of 2008, we determined that these three subsidiaries met the criteria for classification as discontinued operations. The gain on the disposal of these subsidiaries and the financial results associated with 2008 and prior periods are included in discontinued operations.

**Net Income Available for Common Shareholders.** As a result of the factors described above, net income available for common shareholders was ¥12,978,572 (\$1,901,372) for the six months ended December 31, 2009, an increase of ¥4,152,031 (\$608,276) or 47.04% over the same period of 2008.

### ***Liquidity and Capital Resources.***

#### ***General***

**Cash and Cash Equivalents.** Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than three months. On December 31, 2009, we had cash and cash equivalents in the amount of ¥44,987,580 (\$6,590,718). We believe that current cash, cash equivalents, anticipated cash flow from operations and the proceeds from our initial public offering will be sufficient to meet our anticipated cash needs, including cash needs for working capital and capital expenditures for at least the next 12 months.

We may, however, require additional cash due to changing business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our existing cash is insufficient to meet our requirements, we may seek to sell additional equity securities or borrow from banks. However, financing may not be available in the amounts we need or on terms acceptable to us, if at all. The sale of additional equity securities, including convertible debt securities, would dilute our shareholders. The incurrence of debt would divert cash from working capital and capital expenditures to service debt obligations and could result in operating and financial covenants that would restrict our operations and our ability to pay dividends to our shareholders. If we are unable to obtain additional equity or debt financing as required, our business, operations and prospects may suffer.

**Indebtedness.** As of December 31, 2009, except for ¥5,660,874 (\$829,322) of notes payable, we did not have any other outstanding loan capital issued or agreed to be issued, bank overdrafts, loans, debt securities or similar indebtedness, liens, liabilities under acceptance (other than normal trade bills) or acceptance credits, debentures, mortgages, charges, finance leases or hire purchase commitments, guarantees or other material contingent liabilities. In addition, there has not been any material change in our indebtedness, commitments and contingent liabilities since June 30, 2009.

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



**Table of Contents**

These funds may be distributed to shareholders at the time of its wind up. When we were incorporated in the Cayman Islands in August 2007, 5,000,000 ordinary shares were authorized, and 50,000 ordinary shares were issued to Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi, at a par value of \$0.01 each. On December 10, 2007, our company sold 2,632 ordinary shares to an investor at an aggregate consideration of \$200,000. On June 8, 2009, in connection with our initial public offering, the Board of Directors approved a 42.7840667-to-1 split of ordinary shares and redeemable ordinary shares to shareholders of record as of such date. After giving effect to the share split of our ordinary shares and the completion of our initial public offering, we had 3,951,811 ordinary shares outstanding.

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

**Capital Resources.** To date we have financed our operations primarily through cash flows from financing operations. As of December 31, 2009 we had total assets of ¥170,986,668 (\$25,049,689), of which cash amounted to ¥44,987,580 (\$6,590,718), and net accounts receivable (including related party amounts) amounted to ¥92,747,015 (\$13,587,514). Working capital amounted to ¥108,597,021 (\$15,909,554) and shareholders equity amounted to ¥101,456,032 (\$14,863,392). The current ratio equaled 2.78, up from 1.90 at June 30, 2009.

**Cash from Operating Activities.** Net cash used in operating activities was ¥16,912,247 (\$2,477,658) in the six months ended December 31, 2009. Compared to the cash amount used in the operating activities, this was an increase of ¥16,225,746 (\$2,381,480) compared to ¥656,501 (\$96,178) cash used in operating activities for the six months ended December 31, 2008. The increase of receivables reflects the seasonal nature of our business. Our receivables typically increase in the first half calendar year, and we typically receive payments near the end of year, decreasing receivables. The reason for this seasonality is that most of our customers are Chinese state-owned companies and their payment of purchase follows the national budget, which only allows allocation to the operating oil field subsidiaries after July.

The increase in receivables was primarily due to an increase in business contracts in fiscal 2009. The increase in inventory purchased in advance was due to hardware purchases. The increase in accounts payable and accrued liabilities was due to increased purchases of raw materials and other goods. To protect our liquidity, we seek to pay our suppliers as shortly before payments are due as practicable. Both changes in account receivables and payables reflect the seasonal nature of our business. Our revenue has been subject to high seasonality and the revenue recognized in the first quarter is usually the smallest in proportion to that for the whole year in most cases, due to our clients' budgeting and planning schedule. Nevertheless, we continued to experience steady demand for our services from our oil industrial client base.

**Cash from Investing Activities.** Net cash used in investing activities was ¥133,554 (\$19,566) for the six months ended December 31, 2009, a decrease of ¥3,256,038 (\$477,012) compared to the same period in 2008. This decrease in cash used in investing activities was primarily due to the operations we discontinued in 2008.

**Cash from Financing Activities.** Cash flows provided by financing activities amounted to ¥59,381,762 (\$8,699,477) for the six months ended December 31, 2009 and cash flows used in financing activities amounted to ¥453,322 (\$66,412) for the six months ended December 31, 2008. Our financing activities during this period included payback of notes payable and receipt of proceeds from our IPO.

**Working Capital.** Total current assets at December 31, 2009 amounted to ¥169,617,102 (\$24,849,046), an increase of approximately ¥94,391,280 (\$13,828,401) compared to ¥75,225,822 at June 30, 2009. The increase was attributable mainly to an increase in the amount of trade receivables resulting from higher revenues, increased inventories and our IPO.

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## **Table of Contents**

Current liabilities amounted to ¥61,020,081 (\$8,939,492) at December 31, 2009, in comparison to ¥39,594,476 (\$5,800,369) at June 30, 2009. This increase is attributable an increase in the number of projects we have undertaken and our need to order materials for those projects. Also, taxes payable increased significantly, and if we paid that amount at the end of 2009, our working capital might have been affected negatively. In addition, contracts signed during this period featured more guaranteed amounts. The deferred income also increased, leading to an increase of current liabilities.

The current ratio increased from 1.90 at June 30, 2009 to 2.78 at December 31, 2009. The change in our current ratio was primarily due to the IPO. We believe that this changing trend in the current ratio indicates strong operating liquidity for us.

### ***Recently Enacted Accounting Standards***

In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* (ASC Topic 810), which changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in net income and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in net income. SFAS No. 160 is effective for the Company beginning July 1, 2009, and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. The Company believes the adoption of SFAS No. 160 will not have a material impact on the financial statements.

In December 2007, the FASB issued SFAS No. 141(R) (ASC Topic 805), *Business Combinations*, which replaces SFAS No. 141 (ASC Topic 805). The statement retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting (previously referred to as the purchase method of accounting) be used for all business combinations, but requires a number of changes, including changes in the way assets and liabilities are recognized as a result of business combinations. It also requires the capitalization of in-process research and development at fair value and requires the expensing of acquisition-related costs as incurred. In April 2009, the FASB issued FSP FAS 141(R)-1 (ASC Topic 805-10) which amends SFAS No. 141(R) (ASC Topic 805) by establishing a model to account for certain pre-acquisition contingencies. Under the FSP, an acquirer is required to recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer should follow the recognition criteria in SFAS No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss – an interpretation of FASB Statement No. 5*. SFAS No. 141(R) (ASC Topic 805) and FSP FAS 141(R)-1 (ASC Topic 805-10) are effective for us beginning July 1, 2009, and will apply prospectively to business combinations completed on or after that date. The impact of the adoption of SFAS No. 141(R) (ASC Topic 805-10) and FSP FAS 141(R)-1 (ASC Topic 805-10) will depend on the nature of acquisitions completed after the date of adoption.

In December 2008, the FASB issued FSP 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (ASC Topic 860), which promptly improves disclosures by public companies until the pending amendments to SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (ASC Topic 860) and FIN No. 46, *Consolidation of Variable Interest Entities* (revised December 2003) – an interpretation of ARB No. 51 (FIN 46(R)) (ASC Topic 810), are finalized and approved by the Board. The FSP amends SFAS No. 140 to require public companies to provide additional disclosures about transfers of financial assets and variable interests in qualifying special-purpose entities. It also amends FIN 46(R) to require public companies to provide additional disclosures about their involvement with variable interest entities. This FSP is effective for reporting periods ending after December 15, 2008. The Company is currently assessing the effect of SFAS 140-4 (ASC Topic 860-10) and FIN 46(R)-8 (ASC Topic 810-10) on its consolidated financial position and results of operations.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which is effective for the Company beginning July 1, 2010. This Statement amends Financial Accounting Standards Board

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**Table of Contents**

Interpretation ( FIN ) No. 46(R), *Consolidation of Variable Interest Entities an interpretation of ARB No. 51*, to require revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. The Company believes the adoption of this pronouncement will not have a material impact on the financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* or SFAS No. 168. SFAS No. 168 (ASC Topic 105) will become the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related accounting literature. SFAS No. 168 (ASC Topic 105) reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant SEC guidance organized using the same topical structure in separate sections. SFAS No. 168(ASC Topic 105) will be effective for financial statements issued for reporting periods ending after September 15, 2009. This will have an impact on the Company's financial disclosures since all future references to authoritative accounting literature will be references in accordance with SFAS No. 168.

In June 2009, the FASB issued Accounting Standards Update No. 2009-01, *Generally Accepted Accounting Principles (ASC Topic 105)* which establishes the FASB Accounting Standards Codification ( the Codification or ASC ) as the official single source of authoritative U.S. generally accepted accounting principles ( GAAP ). All existing accounting standards are superseded. All other accounting guidance not included in the Codification will be considered non-authoritative. The Codification also includes all relevant Securities and Exchange Commission ( SEC ) guidance organized using the same topical structure in separate sections within the Codification.

Following the Codification, the Board will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ( ASU ) which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification.

The Codification is not intended to change GAAP, but it will change the way GAAP is organized and presented. The Codification is effective for our third-quarter 2009 financial statements and the principal impact on our financial statements is limited to disclosures as all future references to authoritative accounting literature will be referenced in accordance with the Codification. In order to ease the transition to the Codification, we are providing the Codification cross-reference alongside the references to the standards issued and adopted prior to the adoption of the Codification.

In 2006, the FASB issued SFAS No. 157, *Fair Value Measurements (ASC Topic 820)* which defines fair value, establishes a market-based framework or hierarchy for measuring fair value and expands disclosures about fair value measurements. This guidance is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. It does not expand or require any new fair value measures; however the application of this statement may change current practice. We adopted this guidance for financial assets and liabilities effective January 1, 2008 and for non financial assets and liabilities effective January 1, 2009. The adoption, which primarily affected the valuation of our derivative contracts, did not have a material effect on our financial condition or results of operations.

In April 2009, the FASB issued the following updates that provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities:

FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (ASC Topic 820-10-65)*. This update relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the need to exercise judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive.

FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments (ASC topic 320-10-65)*. This update applies to investments in debt securities for which other-than-

## **Table of Contents**

temporary impairments may be recorded. If an entity's management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity may separate other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings) and 2) all other amounts (recorded in Other comprehensive income).

FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (ASC Topic 320-10-65). This update requires fair value disclosures for financial instruments that are not currently reflected on the balance sheet at fair value on a quarterly basis.

We adopted these updates effective June 30, 2009 and the adoption did not have a material effect on our financial condition or results of operations.

In August 2009, FASB issued ASU No. 2009-05 which amends *Fair Value Measurements and Disclosures - Overall* (ASC Topic 820-10) to provide guidance on the fair value measurement of liabilities. This update requires clarification for circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques: 1) a valuation technique that uses either the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities or similar liabilities when traded as an asset; or 2) another valuation technique that is consistent with the principles in ASC Topic 820 such as the income and market approach to valuation. The amendments in this update also clarify that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update further clarifies that if the fair value of a liability is determined by reference to a quoted price in an active market for an identical liability, that price would be considered a Level 1 measurement in the fair value hierarchy. Similarly, if the identical liability has a quoted price when traded as an asset in an active market, it is also a Level 1 fair value measurement if no adjustments to the quoted price of the asset are required. This update is effective for our fourth quarter 2009.

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

Not applicable.

### **Item 4/4T. Controls and Procedures**

#### **Disclosure Controls and Procedures**

As of December 31, 2009, our company carried out an evaluation, under the supervision of and with the participation of management, including our company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of our company's disclosure controls and procedures. Based on the foregoing, the chief executive officer and chief financial officer concluded that our company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in our company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) during the quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, our company's internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

None.

**Item 1A Risk Factors**

Not applicable.

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

(a) None

(b) The section entitled "Use of Proceeds" from our registration statement filed on August 12, 2008, as amended (the "Registration Statement") is incorporated herein by reference. The effective date of the Registration Statement is July 22, 2009, and the Commission file number assigned to the Registration Statement is 333-152964. The Registration Statement registers the offering of up to 1,700,000 ordinary shares (subject to amendment in accordance with the Securities Act of 1933 and the rules and regulations promulgated thereunder) (the "Offering"). As of the date of this report, the Company has not yet spent any proceeds from the Offering because it remains in the PRC application process to bring the proceeds into China.

(c) None

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Table of Contents**

**Item 6. Exhibits**

The following exhibits are filed herewith:

| Number | Exhibit  |
|--------|--|
| 3.1    | Amended and Restated Articles of Association of the Registrant (1)   |
| 3.2    | Amended and Restated Memorandum of Association of the Registrant (1)   |
| 4.1    | Specimen Share Certificate (1)   |
| 10.1   | Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Beijing BHD Petroleum Technology Co., Ltd. (1)             |
| 10.2   | Translation of Power of Attorney for rights of Chen Guangqiang in Beijing BHD Petroleum Technology Co., Ltd. (1)   |
| 10.3   | Translation of Power of Attorney for rights of Yin Shenping in Beijing BHD Petroleum Technology Co., Ltd. (1)  |
| 10.4   | Translation of Power of Attorney for rights of Li Hongqi in Beijing BHD Petroleum Technology Co., Ltd. (1)   |
| 10.5   | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Beijing BHD Petroleum Technology Co., Ltd. (1) |
| 10.6   | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Beijing BHD Petroleum Technology Co., Ltd. (1)    |
| 10.7   | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Li Hongqi and Beijing BHD Petroleum Technology Co., Ltd. (1)       |
| 10.8   | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Beijing BHD Petroleum Technology Co., Ltd. (1)            |
| 10.9   | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Beijing BHD Petroleum Technology Co., Ltd. (1)               |
| 10.10  | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Li Hongqi and Beijing BHD Petroleum Technology Co., Ltd. (1)                  |
| 10.11  | Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Jining ENI Energy Technology Co., Ltd. (1)                 |
| 10.12  | Translation of Power of Attorney for rights of Chen Guangqiang in Jining ENI Energy Technology Co., Ltd. (1)   |
| 10.13  | Translation of Power of Attorney for rights of Yin Shenping in Jining ENI Energy Technology Co., Ltd. (1)  |
| 10.14  | Translation of Power of Attorney for rights of Li Hongqi in Jining ENI Energy Technology Co., Ltd. (1)   |
| 10.15  | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Jining ENI Energy Technology Co., Ltd. (1)     |
| 10.16  | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Jining ENI Energy Technology Co., Ltd. (1)        |
| 10.17  | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Li Hongqi and Jining ENI Energy Technology Co., Ltd. (1)           |
| 10.18  | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Jining ENI Energy Technology Co., Ltd. (1)                |

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**Table of Contents**

|       |   |
|-------|---|
| 10.19 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Jining ENI Energy Technology Co., Ltd. (1)                                |
| 10.20 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Li Hongqi and Jining ENI Energy Technology Co., Ltd. (1)                                   |
| 10.21 | Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Nanjing Recon Technology Co., Ltd. (1)                                  |
| 10.22 | Translation of Power of Attorney for rights of Chen Guangqiang in Nanjing Recon Technology Co., Ltd. (1)  |
| 10.23 | Translation of Power of Attorney for rights of Yin Shenping in Nanjing Recon Technology Co., Ltd. (1)   |
| 10.24 | Translation of Power of Attorney for rights of Li Hongqi in Nanjing Recon Technology Co., Ltd. (1)  |
| 10.25 | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Nanjing Recon Technology Co., Ltd. (1)                      |
| 10.26 | Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Nanjing Recon Technology Co., Ltd. (1)                         |
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| 10.28 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Nanjing Recon Technology Co., Ltd. (1)                                 |
| 10.29 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Nanjing Recon Technology Co., Ltd. (1)                                    |
| 10.30 | Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Li Hongqi and Nanjing Recon Technology Co., Ltd. (1)                                       |
| 31.1  | Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (2) |
| 31.2  | Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (2) |
| 32.1  | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (2)  |
| 32.2  | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (2)  |

(1) Incorporated by reference to the Company's Registration Statement on Form S-1, Registration No. 333-152964.

(2) Filed herewith.

**Table of Contents**

**SIGNATURES**

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

**RECON TECHNOLOGY, LTD**

February 11, 2010

By:

/s/ LIU JIA

**Liu Jia**

**Chief Financial Officer**

**(Principal Financial and Accounting Officer)**

18



**Table of Contents**

RECON TECHNOLOGY, LTD

|   | <b>PAGE</b> |
|---|-------------|
| INDEX TO FINANCIAL STATEMENTS PAGE                                    |             |
| <u>Consolidated Balance Sheets</u>                                    | F-2         |
| <u>Consolidated Statements of Operations and Comprehensive Income</u> | F-3         |
| <u>Consolidated Statements of Cash Flows</u>                          | F-4         |
| <u>Notes to the Consolidated Financial Statements</u>                 | F-5         |

**Table of Contents****RECON TECHNOLOGY, LTD****CONSOLIDATED STATEMENTS OF BALANCE SHEETS**

|   | <b>Chinese Yuan (Renminbi)</b> |  | <b>U.S. Dollars</b>                          |
|---|--------------------------------|--|--|
|   | <b>June 30,<br/>2009</b>       | <b>December 31,<br/>2009<br/>(Unaudited)</b> | <b>December 31,<br/>2009<br/>(Unaudited)</b> |
| <b>ASSETS</b>   |                                |  |  |
| <b>Current assets</b>   |                                |  |  |
| Cash and cash equivalents   | ¥ 2,727,735                    | ¥ 44,987,580                                 | \$ 6,590,718                                 |
| Notes receivable  |                                | 500,000                                      | 73,250                                       |
| Trade accounts receivable, net of allowance for doubtful accounts of ¥604,953 (\$88,570) and ¥995,488 (\$145,840), respectively   | 44,103,981                     | 73,698,215                                   | 10,796,850                                   |
| Trade accounts receivable-related parties, net of allowance for doubtful accounts of ¥350,498 (\$51,316) and ¥0(\$ 0), respectively   | 7,458,302                      | 19,048,800                                   | 2,790,665                                    |
| Other receivables, net of allowance for doubtful accounts of ¥1,291,923 (\$189,149) and ¥677,664(\$99,278), respectively  | 2,048,015                      | 4,706,571                                    | 689,517                                      |
| Other receivables-related parties, net of allowance for doubtful accounts of ¥169,074 (\$24,754) and ¥0(\$0), respectively  | 507,541                        | 116,615                                      | 17,084                                       |
| Purchase advances, net of allowance for doubtful accounts of ¥1,239,234 (\$181,435) and ¥1,303,901(\$191,023), respectively   | 5,637,082                      | 12,870,544                                   | 1,885,545                                    |
| Purchase advances-related parties   | 73,028                         |  |  |
| Prepaid expenses  | 338,072                        | 737,502                                      | 108,045                                      |
| Inventories   | 10,710,018                     | 12,951,275                                   | 1,897,372                                    |
| Deferred offering costs   | 1,622,048                      |  |  |
| <b>Total current assets</b>   | <b>75,225,822</b>              | <b>169,617,102</b>                           | <b>24,849,046</b>                            |
| Property and equipment, net of accumulated depreciation of ¥1,006,761 (\$147,398) and ¥993,029(\$145,479), respectively   | 1,406,876                      | 1,369,566                                    | 200,643                                      |
|   | ¥ 76,632,698                   | ¥ 170,986,668                                | \$ 25,049,688                                |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                |  |  |
| <b>Current liabilities</b>  |                                |  |  |
| Trade accounts payable  | ¥ 15,601,101                   | ¥ 27,720,220                                 | \$ 4,061,035                                 |
| Trade accounts payable-related parties  | 189,744                        | 85,876                                       | 12,581                                       |
| Other payables  | 1,767,005                      | 2,019,718                                    | 295,890                                      |
| Other payables-related parties  | 73,579                         | 375,300                                      | 54,982                                       |
| Deferred income   | 2,361,605                      | 5,040,141                                    | 738,385                                      |
| Advances from customers   | 910,215                        | 25,650                                       | 3,758  |
| Accrued payroll and employees' welfare  | 393,074                        | 391,794                                      | 57,398                                       |
| Accrued expenses  | 262,083                        | 433,490                                      | 63,507                                       |
| Taxes payable   | 9,182,676                      | 12,978,260                                   | 1,901,326                                    |
| Short-term notes payable  | 3,143,792                      | 3,936,799                                    | 576,744                                      |
| Short-term notes payable-related parties  | 3,344,377                      | 1,724,075                                    | 252,578                                      |
| Deferred tax liabilities  | ¥ 2,365,225                    | ¥ 6,288,758                                  | \$ 921,308                                   |
| <b>Total current liabilities</b>  | <b>39,594,476</b>              | <b>61,020,080</b>                            | <b>8,939,492</b>                             |
| <b>Redeemable ordinary shares</b>   | <b>1,434,342</b>               |  |  |
| <b>Shareholders' equity</b>   |                                |  |  |
| Ordinary shares, \$0.0185 U.S. dollar par value, 25,000,000 shares authorized; 2,139,203 and 3,951,811 shares issued and outstanding as of June 30, 2009 and December 31, 2009 respectively | 300,534                        | 529,637                                      | 77,592                                       |

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|  |                   |                    |                   |
|--|-------------------|--------------------|-------------------|
| Additional paid-in capital                   | 8,732,266         | 68,292,476         | 10,004,904        |
| Appropriated retained earnings               | 1,687,772         | 2,926,830          | 428,783           |
| Unappropriated retained earnings             | 18,043,692        | 29,762,625         | 4,360,249         |
| <b>Other comprehensive loss</b>              |                   | (55,536)           | (8,136)           |
| <b>Total controlling shareholders equity</b> | <b>28,764,264</b> | <b>101,456,031</b> | <b>14,863,393</b> |
| <b>Non-controlling interest, net of tax</b>  | <b>6,839,616</b>  | <b>8,510,556</b>   | <b>1,246,804</b>  |
| <b>Total shareholders equity</b>             | <b>35,603,880</b> | <b>109,966,588</b> | <b>16,110,196</b> |
|  | ¥ 76,632,698      | ¥ 170,986,668      | \$ 25,049,688     |

See notes to the consolidated financial statements.

F-2

Table of Contents

## RECON TECHNOLOGY, LTD

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

|   | Chinese Yuan (Renminbi)<br>For the Six Months ended<br>December 31, |                     | Chinese Yuan (Renminbi)<br>For the Three Months ended<br>December 31, |                     | U.S. Dollars<br>For the Six Months ended |
|---|---|---------------------|---|---------------------|--|
|   | 2009<br>(Unaudited)   | 2008<br>(Unaudited) | 2009<br>(Unaudited)   | 2008<br>(Unaudited) | December 31,<br>2009<br>(Unaudited)      |
| <b>Revenues</b>   |   |                     |   |                     |  |
| Hardware  | ¥ 66,353,385  | ¥ 47,675,310        | ¥ 47,081,742  | ¥ 37,502,067        | \$ 9,720,826                             |
| Service   | 5,965,812   | 1,400,000           | 2,992,353   | 1,306,667           | 873,996                                  |
| Software  | 226,496   | 649,573             |   | 649,573             | 33,182                                   |
| <b>Total revenues</b>   | <b>72,545,692</b>   | <b>49,724,883</b>   | <b>50,074,094</b>   | <b>39,458,307</b>   | <b>10,628,004</b>                        |
| <b>Cost of revenues</b>   | <b>41,469,158</b>   | <b>31,141,366</b>   | <b>25,396,611</b>   | <b>22,338,687</b>   | <b>6,075,266</b>                         |
| <b>Gross margin</b>   | <b>31,076,535</b>   | <b>18,583,517</b>   | <b>24,677,484</b>   | <b>17,119,620</b>   | <b>4,552,738</b>                         |
| <b>Operating expenses</b>   |   |                     |   |                     |  |
| Selling and distribution expenses   | 6,023,098   | 3,337,674           | 3,863,886   | 2,606,958           | 882,389                                  |
| General and administrative expenses   | 6,465,900   | 3,227,615           | 3,520,245   | 1,643,679           | 947,260                                  |
|   | 12,488,998  | 6,565,289           | 7,384,131   | 4,250,637           | 1,829,649                                |
| <b>Income from operations</b>   | <b>18,587,537</b>   | <b>12,018,229</b>   | <b>17,293,353</b>   | <b>12,868,984</b>   | <b>2,723,089</b>                         |
| <b>Subsidy income</b>   | <b>1,158,034</b>  | <b>1,664,615</b>    | <b>1,131,709</b>  | <b>1,134,700</b>    | <b>169,653</b>                           |
| <b>Interest income</b>  | <b>5,772</b>  | <b>11,925</b>       | <b>4,096</b>  | <b>8,465</b>        | <b>846</b>                               |
| <b>Interest expense</b>   | <b>(77,313)</b>   | <b>(60,029)</b>     | <b>(36,069)</b>   | <b>(60,029)</b>     | <b>(11,326)</b>                          |
| <b>Other income</b>   | <b>82,246</b>   | <b>38,167</b>       | <b>8,774</b>  | <b>38,167</b>       | <b>12,049</b>                            |
| <b>Income before income taxes and non-controlling interest</b>                | <b>19,756,277</b>   | <b>13,672,906</b>   | <b>18,401,864</b>   | <b>13,990,286</b>   | <b>2,894,311</b>                         |
| <b>Provision for income taxes</b>   | <b>(5,106,765)</b>  | <b>(3,251,109)</b>  | <b>(4,414,087)</b>  | <b>(3,231,050)</b>  | <b>(748,145)</b>                         |
| <b>Income from continuing operations</b>                                      | <b>14,649,512</b>   | <b>10,421,797</b>   | <b>13,987,777</b>   | <b>10,759,236</b>   | <b>2,146,166</b>                         |
| <b>Loss from operations of discontinued subsidiaries, net of income taxes</b> |   | <b>(442,547)</b>    |   |                     |  |
| <b>Net income</b>   | <b>14,649,512</b>   | <b>9,979,250</b>    | <b>13,987,777</b>   | <b>10,759,236</b>   | <b>2,146,166</b>                         |
| <b>Non-controlling interest, net of tax</b>                                   | <b>(1,670,940)</b>  | <b>(1,118,422)</b>  | <b>(1,433,624)</b>  | <b>(1,167,959)</b>  | <b>(244,794)</b>                         |
| <b>Accrued dividend for redeemable ordinary shares</b>                        |   | <b>(34,287)</b>     |   | <b>(51,521)</b>     |  |
| <b>Net income available for common shareholders</b>                           | <b>¥ 12,978,572</b>   | <b>¥ 8,826,541</b>  | <b>¥ 12,554,153</b>   | <b>¥ 9,574,224</b>  | <b>\$ 1,901,371</b>                      |
| <b>Basic earnings (loss) per share:</b>                                       |   |                     |   |                     |  |
| Income from continuing operations   | ¥ 4.01  | ¥ 4.87              | ¥ 3.54  | ¥ 5.03              | \$ 0.59                                  |
| Loss from discontinued operations   | ¥   | ¥ (0.21)            | ¥   | ¥                   | \$                                       |
| Net income  | ¥ 4.01  | ¥ 4.66              | ¥ 3.54  | ¥ 5.03              | \$ 0.59                                  |

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|   |   |            |   |           |   |            |   |            |    |           |
|---|---|------------|---|-----------|---|------------|---|------------|----|-----------|
| Net income available for common shareholders                          | ¥ | 3.55       | ¥ | 4.13      | ¥ | 3.18       | ¥ | 4.48       | \$ | 0.52      |
| <b>Basic weighted average ordinary shares outstanding</b>             |   | 3,656,277  |   | 2,139,203 |   | 3,951,811  |   | 2,139,203  |    | 3,656,277 |
| <b>Diluted earnings (loss) per share:</b>                             |   |            |   |           |   |            |   |            |    |           |
| Income from continuing operations                                     | ¥ | 3.96       | ¥ | 4.63      | ¥ | 3.46       | ¥ | 4.78       | \$ | 0.58      |
| Loss from discontinued operations                                     | ¥ |            | ¥ | (0.20)    | ¥ |            | ¥ |            | \$ |           |
| Net income  | ¥ | 3.96       | ¥ | 4.43      | ¥ | 3.46       | ¥ | 4.78       | \$ | 0.58      |
| Net income available for common shareholders                          | ¥ | 3.51       | ¥ | 3.92      | ¥ | 3.10       | ¥ | 4.25       | \$ | 0.51      |
| <b>Diluted weighted average ordinary shares outstanding</b>           |   | 3,698,981  |   | 2,251,811 |   | 4,046,573  |   | 2,251,811  |    | 3,698,981 |
| <b>Comprehensive income (loss)</b>                                    |   |            |   |           |   |            |   |            |    |           |
| Net income  |   | 14,649,512 |   | 9,944,963 |   | 13,987,777 |   | 10,742,183 |    | 2,146,166 |
| Foreign currency translation adjustment                               |   | (55,536)   |   |           |   | (3,763)    |   |            |    | (8,136)   |
| Comprehensive income (loss)   | ¥ | 14,593,976 | ¥ | 9,944,963 | ¥ | 13,984,014 | ¥ | 10,742,183 | \$ | 2,138,030 |
| Comprehensive income (loss) attributable to non- controlling interest |   | 1,670,940  |   | 1,118,422 |   | 1,433,624  |   | 1,167,959  |    | 244,794   |
| Comprehensive income (loss) attributable to common shareholders       | ¥ | 12,923,036 | ¥ | 8,826,541 | ¥ | 12,550,390 | ¥ | 9,574,224  | \$ | 1,893,236 |

See notes to the consolidated financial statements.

**Table of Contents****RECON TECHNOLOGY, LTD****CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | Chinese Yuan (Renminbi)<br>For the Six Months ended<br>December 31, |                      | U.S.Dollars<br>For the Six Months ended |
|--|---|----------------------|---|
|  | 2009<br>(Unaudited)   | 2008<br>(Unaudited)  | December 31,<br>2009<br>(Unaudited)     |
| <b>Cash flows from operating activities:</b>   |   |                      |   |
| Net income (loss) available for common shareholders                                      | ¥ 12,978,572  | ¥ 8,826,541          | \$ 1,901,371                            |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |   |                      |   |
| Depreciation   | 170,864   | 238,995              | 25,032                                  |
| Stock based payment  | 736,688   |                      | 107,925                                 |
| Minority interest  | 1,670,940   | 1,118,422            | 244,794                                 |
| Accrued dividend for redeemable common stock   |   | 34,287               |   |
| Allowance for short-term notes receivables   |   | 2,704,594            |   |
| Unrealized gain or loss on marketable securities   |   | 55,516               |   |
| Gain on currency remeasurement   |   | (7,492)              |   |
| Movement of deferred taxation  | 3,923,533   |                      | 574,801                                 |
| <b>Changes in operating assets and liabilities:</b>                                      |   |                      |   |
| Trade accounts receivable, net   | (29,594,234)  | (10,627,525)         | (4,335,580)                             |
| Trade accounts receivable-related parties, net   | (11,590,498)  | (2,519,601)          | (1,698,018)                             |
| Other receivable, net  | (1,484,297)   | (3,338,538)          | (217,451)                               |
| Other receivable related parties, net  | (500,000)   | 99,550               | (73,250)                                |
| Purchase advance, net  | (783,333)   | (1,285,685)          | (114,759)                               |
| Prepaid expense  | (7,160,434)   | (588,270)            | (1,049,009)                             |
| Inventories  | (399,430)   | 521,981              | (58,517)                                |
| Trade accounts payable   | (2,241,257)   | (2,298,793)          | (328,346)                               |
| Trade accounts payable-related parties   | 12,119,119  | 5,215,817            | 1,775,461                               |
| Other payables   | (103,868)   | (2,693,832)          | (15,217)                                |
| Other payables-related parties   | (326,557)   | (91,143)             | (47,841)                                |
| Deferred income  |   | (1,631,382)          |   |
| Advances from customers  | 2,678,536   | (476,326)            | 392,408                                 |
| Accrued payroll  | (884,565)   | (38,346)             | (129,590)                               |
| Accrued employees' welfare   | (1,281)   | (292,467)            | (188)                                   |
| Accrued expense  |   | 299,734              |   |
| Taxes payable  | 171,407   | 6,004,062            | 25,111                                  |
| Interest payable   | 3,707,849   | 113,400              | 543,203                                 |
| <b>Net cash (used in) provided by operating activities</b>                               | <b>¥ (16,912,247)</b>   | <b>¥ (656,501)</b>   | <b>\$ (2,477,658)</b>                   |
| <b>Cash flows from investing activities:</b>   |   |                      |   |
| Purchases of property and equipment  | (133,554)   | (683,097)            | (19,566)                                |
| Proceeds from sale of property and equipment   |   | (113,400)            |   |
| Decrease in cash resulting from de-consolidation of variable interest entities           |   | (2,763,095)          |   |
| Proceeds from short-term notes receivable  |   | 170,000              |   |
| <b>Net cash used in investing activities</b>   | <b>¥ (133,554)</b>  | <b>¥ (3,389,592)</b> | <b>\$ (19,566)</b>                      |
| <b>Cash flows from financing activities:</b>   |   |                      |   |
| Proceeds from stock issuance   | 60,209,057  |                      | 8,820,677                               |

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|  |                     |                      |                     |
|--|---------------------|----------------------|---------------------|
| Proceeds from short-term notes payable                                 | 1,806,464           | 758,991              | 264,648             |
| Repayment of short-term notes payable                                  |                     | (478,576)            |                     |
| Repayment of long-term notes payable                                   |                     | (357,737)            |                     |
| Proceeds from short-term notes payable-related party                   | (2,633,759)         | (376,000)            | (385,848)           |
| <b>Net cash (used in) provided by financing activities</b>             | <b>¥ 59,381,762</b> | <b>¥ (453,322)</b>   | <b>\$ 8,699,477</b> |
| <b>Effect of exchange rate fluctuation on cash and cash equivalent</b> | <b>(76,116)</b>     |                      | <b>(11,151)</b>     |
| <b>Net change in cash</b>  | <b>¥ 42,259,845</b> | <b>¥ (4,499,415)</b> | <b>\$ 6,191,102</b> |
| <b>Cash and cash equivalents at beginning of period</b>                | <b>2,727,735</b>    | <b>9,034,560</b>     | <b>399,598</b>      |
| <b>Cash and cash equivalents at end of period</b>                      | <b>¥ 44,987,580</b> | <b>¥ 4,535,145</b>   | <b>\$ 6,590,428</b> |
| <b>Supplemental cash flow information</b>                              |                     |                      |                     |
| Cash paid during the period for interest                               |                     |                      |                     |
| Cash paid during the period for taxes                                  | 248,176             | 811,267              | 36,356              |

See notes to the consolidated financial statements.

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**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION**

**Organization** - Recon Technology, Ltd (the Company) was incorporated under the laws of the Cayman Islands on August 21, 2007 by Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi (the Principal Shareholders) as a company with limited liability. The Company provides services designed to automate and enhance the extraction of petroleum in the People's Republic of China (the PRC). Its wholly owned subsidiary, Recon Technology, Co., Limited (Recon-HK) was incorporated on September 6, 2007 in Hong Kong. Other than the equity interest in Recon-HK, the Company does not own any assets or conduct any operations. On November 15, 2007, Recon-HK established one wholly owned subsidiary, Jining Recon Technology, Ltd. (Recon-JN) under the laws of the PRC. Other than the equity interest in Recon-JN, Recon-HK does not own any assets or conduct any operations.

Recon-JN conducts its business through the following PRC legal entities that are consolidated as variable interest entities (VIEs) and operate in the Chinese petroleum industry:

Beijing BHD Petroleum Technology Co., Ltd. (BHD),

Nanjing Recon Technology Co., Ltd. (Nanjing Recon), and

Jining ENI Energy Technology Co., Ltd. (ENI)

The following former subsidiaries of BHD entities were sold by June 2008:

Inner Mongolia Adar Energy Technology (Inner Mongolia Adar)

Beijing Weigu Windows Co. Technology (Beijing Weigu)

The following former subsidiaries of Nanjing Recon were sold by June 2009:

Xiamen Recon Technology, Ltd. (Xiamen Recon).

Xiamen Hengda Haitian (Hengda Haitian)

Beijing YabeiNuoda Technology, Ltd. (Yabei Nuoda).

Chinese laws and regulations currently do not prohibit or restrict foreign ownership in petroleum businesses. However, Chinese laws and regulations do prevent direct foreign investment in certain industries. On January 1, 2008, to protect the Company's shareholders from possible future foreign ownership restrictions, the Principal Shareholders, who also hold the controlling interest of BHD, Nanjing Recon and ENI, reorganized the corporate and shareholding structure of these entities by entering into certain exclusive agreements with Recon-JN, which entitles Recon-JN to receive a majority of the residual returns. On May 29, 2009 Recon JN and BHD, Nanjing Recon, and ENI entered into an operating agreement to provide full guarantee for the performance of such contracts, agreements or transactions entered into by BHD, Nanjing Recon, and ENI. As a result of the new agreement, Recon-JN will absorb 100% of the expected losses and receive 90% of the expected gains of BHD, Nanjing Recon, and ENI, which results in Recon-JN being the primary beneficiary of these Companies.



**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Recon-JN also entered into Share Pledge Agreements with the Principal Shareholders, who pledged all their equity interest in these entities to Recon-JN. The Share Pledge Agreements, which were entered into by each Principal Shareholder, pledged each of the Principal Shareholders equity interest in BHD, Nanjing Recon and ENI as a guarantee for the service payment under the Service Agreement.

The Service Agreement, entered into on January 1, 2008, between Recon-JN and BHD, Nanjing Recon, and ENI, states that Recon-JN will provide technical consulting services to BHD, Nanjing Recon, and ENI in exchange for 90% of their annual net profits as a service fee, which is to be paid quarterly.

In addition, Recon-HK entered into Option Agreements to acquire the Principal Shareholders equity interest in these entities if or when permitted by the PRC laws.

Based on these exclusive agreements, the Company consolidates BHD, Nanjing Recon and ENI as VIEs as required by Financial Accounting Standards Board ( FASB ) Interpretation No. 46R ( FIN 46(R) ) (ASC Topic 810), *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*(ASC Topic 810) because the Company is the primary beneficiary of the VIEs.

On August 28, 2000 a Principal Shareholder of the Company purchased a controlling interest in BHD which was organized under the laws of the PRC on June 29, 1999. As at December 31, 2008 and 2009, the Principal Shareholder held 67.5% ownership in BHD. BHD is combined with the Company through the date of the exclusive agreements, and is consolidated following January 1, 2008, the date of the agreements based on FIN 46(R) (ASC Topic 810). The profits and losses to the Company are allocated based upon the control agreements, which is 90% and 100%, respectively. The profits allocated to the minority interest are the remaining amount (10%).

On April 18, 2007, BHD organized Inner Mongolia Adar under the laws of the PRC, of which BHD owned a 70% majority interest. On May 11, 2007 BHD created another subsidiary, Beijing Weigu, of which BHD held a 90% interest. On June 21, 2008 Beijing Weigu was sold to unrelated parties. On June 24, 2008 Inner Mongolia Adar was sold to unrelated parties. Inner Mongolia Adar and Beijing Weigu are consolidated with BHD for all periods presented to the date of disposition.

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**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On January 21, 2003, ENI was organized under the laws the PRC. Principal Shareholders of the Company own a controlling interest of ENI. As at December 31, 2008 and 2009, the Principal Shareholders held 80% ownership interest in ENI. ENI is combined with the Company through the date of the exclusive agreements, and is consolidated following January 1, 2008, the date of the agreements based on FIN 46(R) (ASC Topic 810). The profits and losses to the Company are allocated based upon the control agreements, which is 90% and 100%, respectively. The profits allocated to the minority interest are the remaining amount (10%).

On August 27, 2007 the Principal Shareholders of the Company purchased a majority ownership of Nanjing Recon from a related party who was a majority owner of Nanjing Recon. At September 30, 2008 and 2009, the Principal Shareholders held 80% ownership interest in Nanjing Recon. Nanjing Recon was organized under the laws of the PRC on July 4, 2003. Nanjing Recon is combined with the Company through the date of the exclusive agreements, and is consolidated following January 1, 2008, the date of the agreements based on FIN 46(R) (ASC Topic 810). The profits and losses to the Company are allocated based upon the control agreements, which is 90% and 100%, respectively. The profits allocated to the minority interest are the remaining amount (10%).

***Nature of Operations*** - The Company is mainly engaged in (1) providing equipment, tools and other hardware related to oilfield production and management. Simple installations may happen in connection with some projects; (2) developing and selling its own specialized industrial automation control and information solutions. The products and services provided by the Company include:

***Oil Field Water Finding/Blocking Technology*** - The Company developed this technology designed to find and block water content in petroleum.

***High-Efficiency Heating Furnaces*** - High-Efficiency Heating Furnaces are designed to remove the impurities and to prevent solidification blockage in transport pipes carrying crude petroleum. Crude petroleum contains certain impurities that must be removed before the petroleum can be sold, including water and natural gas.

***Multi-Purpose Fissure Shaper*** - Multipurpose fissure shapers improve the extractors ability to test for and extract petroleum which must be perforated into the earth before any petroleum extractor can test for the presence of oil.

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

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation and Translating Financial Statements*** - The accompanying consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ). They are combined through the date of the exclusive agreements, and they are consolidated following January 1, 2008, the date of the agreements. The accompanying consolidated financial statements include the financial statements of the Company, its subsidiaries, and VIEs for which the Company is the primary beneficiary. All inter-company transactions and balances between the Company, its subsidiaries and VIEs are eliminated upon consolidation. In the opinion of management, all adjustments considered necessary for a fair presentation have been included, and such adjustments are of a normal recurring nature.

***Convenience Translation*** - The Company's functional currency is the Chinese Yuan ( Renminbi ) and the accompanying consolidated financial statements have been expressed in Chinese Yuan. The consolidated financial statements as of and for the period ended December 31, 2009 have been translated into United States dollars ( U.S. dollars ) solely for the convenience of the readers and are unaudited. The translation has been made at the rate of ¥ 6.8259= US\$1.00, the approximate exchange rate prevailing on December 31, 2009. These translated U.S. dollar amounts should not be construed as representing Chinese Yuan amounts or that the Chinese Yuan amounts have been or could be converted into U.S. dollars.

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

***Fair Values of Financial Instruments*** - The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, advances to suppliers, trade accounts payable, accrued liabilities, advances from customers and notes payable approximate fair value because of the immediate or short-term maturity of these financial instruments.

***Cash and Cash Equivalents*** - Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than three months.

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Trade Accounts and Other Receivables** - Accounts receivable are recorded when revenue is recognized and are carried at original invoiced amount less a provision for any potential uncollectible amounts. Provision is made against trade accounts and other receivables to the extent they are considered to be doubtful. Other receivables are from transactions with non-trade customers.

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

**Inventories** - Inventories are stated at the lower of cost or market value, on a weighted average basis. The method of determining inventory costs is used consistently from year to year. Allowance for inventory obsolescence is provided when the market value of certain inventory items are lower than the cost.

**Valuation of Long-lived Assets** - The carrying values of the Company's long-lived assets are reviewed for impairment annually or whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, the Company projects the undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, the carrying value of the long-lived asset is reduced by the estimated excess of the carrying value over the projected discounted cash flows.

**Advances from Customers** - The Company, as is common practice in the PRC, will often receive advance payments from its customers for its products. The advances are showed as a current liabilities and are recognized as revenue when the products are delivered

**Stock Split** - On June 8, 2009, in connection with the Company's contemplated initial public offering ( IPO ) of ordinary shares, the Board of Directors approved a 42.7840667-to-1 split of ordinary shares and redeemable ordinary shares to shareholders of record as of such date. All references to the number of ordinary shares and per share amounts have been restated as appropriate to reflect the effect of the split for all periods presented.

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

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Hardware:***

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

***Software:***

The Company sells self-developed software. For software sales, the Company recognizes revenues in accordance with the provisions of Statement of Position No. 97-2 (ASC985-605), Software Revenue Recognition, and related interpretations. Revenue from software is recognized according to project contracts. Contract costs are accumulated during the periods of installation and testing or commissioning. Usually this is short term. Profits are not recognized until completion of the contracts. Costs included in inventory as work in process include direct materials, labor and related expense. Corporate general and administrative expenses are charged to expense in the period they are incurred.

***Services:***

The Company provides services to improve software functions and system requirements on separated fixed-price contracts. Revenue is recognized on the completed contract method when acceptance is determined by a completion report signed by the customer. Deferred revenue represents unearned amounts billed to customers related to service agreements.

Revenues applicable to multiple-element fee arrangements are divided among the elements such as software, hardware and post-contract service using vendor-specific objective evidence of fair value. Such evidence consists of pricing of multiple elements when those same elements are sold as separate products or arrangements. Software maintenance for the first year and initial training are included in the purchase price of the software. Initial training is provided at the time of installation and is recognized as income as part of the price of the software since it is minimal in value. Maintenance is valued based on the fee schedule used by us for providing the regular level of maintenance service as sold to customers when renewing their maintenance contracts on a standalone basis. Maintenance revenue is included in the income statement under services and is recognized over the term of the agreement.

***Cost of Revenues*** - When the criteria for revenue recognition have been met, costs incurred are recognized as cost of revenue. Cost of revenues include wages, materials, handling charges, and other expenses associated with manufactured products and service provided to customers; the cost of purchased equipment and pipes.

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Subsidy Income** - The Company received grants of ¥1,158,034 and ¥1,664,615 from the local government for the six months ended December 31, 2009 and 2008, respectively. These grants were given by the government to support local software companies' operation and research and development. Grants related to research and development projects are recognized as subsidy income in the consolidated statements of operations when related expenses are recorded. Grants in form of value-added-tax refund are recognized when received.

**Share-Based Compensation** - The Company accounts for share-based compensation in accordance with SFAS No. 123(R) (ASC Topic 718), *Share-Based Payment*. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the applicable vesting period of the share award using the straight-line method.

**Income Taxes** - Income taxes are provided based upon the liability method of accounting pursuant to SFAS No. 109 (ASC Topic 740), *Accounting for Income Taxes*. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes. Deferred taxes are provided on differences between the tax bases of assets and liabilities and their reported amounts in the financial statements, and tax carry forwards. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company has not been subject to any income taxes in the United States or the Cayman Islands.

**Business Segments** - The Company operates in one industry which includes the sale of products for the oil field construction solely to customers in China; therefore, no business segment information has been presented.

**Earnings per Ordinary Share (EPS)** - Basic EPS is computed by dividing net income available for common shareholders by the weighted average number of ordinary shares outstanding. Diluted EPS are computed by dividing net income available for common shareholders by the weighted-average number of ordinary shares and dilutive potential ordinary share equivalents outstanding.

**Recently Enacted Accounting Standards** - In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* (ASC Topic 810), which changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a

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**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in net income and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in net income. SFAS No. 160 is effective for the Company beginning July 1, 2009, and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. The Company believes the adoption of SFAS No. 160 will not have a material impact on the financial statements.

In December 2007, the FASB issued SFAS No. 141(R) (ASC Topic 805), *Business Combinations*, which replaces SFAS No. 141 (ASC Topic 805). The statement retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting (previously referred to as the purchase method of accounting) be used for all business combinations, but requires a number of changes, including changes in the way assets and liabilities are recognized as a result of business combinations. It also requires the capitalization of in-process research and development at fair value and requires the expensing of acquisition-related costs as incurred. In April 2009, the FASB issued FSP FAS 141(R)-1 (ASC Topic 805-10) which amends SFAS No. 141(R) (ASC Topic 805) by establishing a model to account for certain pre-acquisition contingencies. Under the FSP, an acquirer is required to recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer should follow the recognition criteria in SFAS No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss – an interpretation of FASB Statement No. 5*. SFAS No. 141(R) (ASC Topic 805) and FSP FAS 141(R)-1 (ASC Topic 805-10) are effective for us beginning July 1, 2009, and will apply prospectively to business combinations completed on or after that date. The impact of the adoption of SFAS No. 141(R) (ASC Topic 805) and FSP FAS 141(R)-1 (ASC Topic 805-10) will depend on the nature of acquisitions completed after the date of adoption.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies the sources of accounting principles and provides entities with a framework for selecting the principles used in preparation of financial statements that are presented in conformity with GAAP. The current GAAP hierarchy has been criticized because it is directed to the auditor rather than the entity, it is complex, and it ranks FASB Statements of Financial Accounting Concepts, which are subject to the same level of due process as FASB Statements of Financial Accounting Standards, below industry practices that are widely recognized as generally accepted but that are not subject to due process. The Board believes the GAAP hierarchy should be directed to entities because it is the entity (not its auditors) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. The adoption of FASB 162 is not expected to have a material impact on the Company's financial statements.

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP 03-6-1) (ASC Topic 260-10-45), which classifies unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents as participating securities and requires them to be included in the computation of earnings per share pursuant to the two-class method described in SFAS No. 128, *Earnings per Share*. FSP 03-6-1(ASC Topic 260-10-45) is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. It requires all prior period earnings per share data presented to be adjusted retrospectively. The Company is currently evaluating the effect, if any, that the adoption of FSP 03-6-1(ASC Topic 260-10-45) will have on its consolidated financial position, results of operations and cash flows.

In April 2009, the FASB issued three FSPs that are intended to provide additional application guidance and enhance disclosures about fair value measurements and impairments of securities. FSP 157-4 (ASC Topic 820-10) clarifies the objective and method of fair value measurement even when there has been a significant decrease in market activity for the asset being measured. FSP 115-2 (ASC Topic 320-10) and FSP 124-2 (ASC Topic 320-10) establish a new model for measuring other-than-temporary impairments for debt securities, including establishing criteria for when to recognize a write-down through earnings versus other comprehensive income. FSP 107-1 and APB 28-1(ASC Topic 825-10) expands the fair value disclosures required for all financial instruments within the scope of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* (ASC Topic 26), to interim periods. The Company does not expect the adoptions of the three Staff Positions have a material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which is effective for the Company beginning July 1, 2010. This Statement amends Financial Accounting Standards Board Interpretation ( FIN ) No. 46(R), *Consolidation of Variable Interest Entities an interpretation of ARB No. 51*, to require revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. The Company believes the adoption of this pronouncement will not have a material impact on the financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* or SFAS No. 168. SFAS No. 168(ASC Topic 105) will become the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and



**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

related accounting literature. SFAS No. 168 (ASC Topic 105) reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant SEC guidance organized using the same topical structure in separate sections. SFAS No. 168 (ASC Topic 105) will be effective for financial statements issued for reporting periods ending after September 15, 2009. This will have an impact on the Company's financial disclosures since all future references to authoritative accounting literature will be references in accordance with SFAS No. 168.

In June 2009, the FASB issued Accounting Standards Update No. 2009-01, *Generally Accepted Accounting Principles (ASC Topic 105)* which establishes the FASB Accounting Standards Codification (the Codification or ASC) as the official single source of authoritative U.S. generally accepted accounting principles (GAAP). All existing accounting standards are superseded. All other accounting guidance not included in the Codification will be considered non-authoritative. The Codification also includes all relevant Securities and Exchange Commission (SEC) guidance organized using the same topical structure in separate sections within the Codification.

Following the Codification, the Board will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates (ASU) which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification.

The Codification is not intended to change GAAP, but it will change the way GAAP is organized and presented. The Codification is effective for our third-quarter 2009 financial statements and the principal impact on our financial statements is limited to disclosures as all future references to authoritative accounting literature will be referenced in accordance with the Codification. In order to ease the transition to the Codification, we are providing the Codification cross-reference alongside the references to the standards issued and adopted prior to the adoption of the Codification.

In 2006, the FASB issued SFAS No. 157, *Fair Value Measurements (ASC Topic 820)* which defines fair value, establishes a market-based framework or hierarchy for measuring fair value and expands disclosures about fair value measurements. This guidance is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. It does not expand or require any new fair value measures; however the application of this statement may change current practice. We adopted this guidance for financial assets and liabilities effective January 1, 2008 and for non financial assets and liabilities effective January 1, 2009. The adoption, which primarily affected the valuation of our derivative contracts, did not have a material effect on our financial condition or results of operations.

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**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In April 2009, the FASB issued the following updates that provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities:

FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (ASC Topic 820-10-65). This update relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the need to exercise judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive.

FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (ASC topic 320-10-65). This update applies to investments in debt securities for which other-than-temporary impairments may be recorded. If an entity's management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity may separate other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings) and 2) all other amounts (recorded in Other comprehensive income).

FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (ASC Topic 320-10-65). This update requires fair value disclosures for financial instruments that are not currently reflected on the balance sheet at fair value on a quarterly basis. We adopted these updates effective June 30, 2009 and the adoption did not have a material effect on our financial condition or results of operations.

In August 2009, FASB issued ASU No. 2009-05 which amends Fair Value Measurements and Disclosures - Overall (ASC Topic 820-10) to provide guidance on the fair value measurement of liabilities. This update requires clarification for circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques: 1) a valuation technique that uses either the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities or similar liabilities when traded as an asset; or 2) another valuation technique that is consistent with the principles in ASC Topic 820 such as the income and market approach to valuation. The amendments in this update also clarify that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update further clarifies that if the fair value of a liability is determined by reference to a quoted price in an active market for an identical liability, that price would be considered a Level 1 measurement in the fair value hierarchy. Similarly, if the identical liability has a quoted price when traded as an asset in an active market, it is also a Level 1 fair value measurement if no adjustments to the quoted price of the asset are required. This update is effective for our fourth quarter 2009.

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 3. TRADE ACCOUNTS RECEIVABLE**

Accounts receivable consisted of the following at June 30, 2009 and December 31, 2009:

|                                 | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|---------------------------------|-------------------------|-------------------------------------|-------------------------------------|
|                                 | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| Trade accounts receivable       | ¥ 44,708,934            | ¥ 74,693,703                        | \$ 10,942,689                       |
| Allowance for doubtful accounts | (604,953)               | (995,488)                           | (145,840)                           |
| Trade accounts receivable, net  | ¥ 44,103,981            | ¥ 73,698,215                        | \$ 10,796,850                       |

**NOTE 4. INVENTORIES**

Inventories consisted of the following at June 30, 2009 and December 31, 2009:

|                                   | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|-----------------------------------|-------------------------|-------------------------------------|-------------------------------------|
|                                   | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| Purchased goods and raw materials | ¥ 228,569               | ¥ 6,000,116                         | \$ 879,022                          |
| Work in process                   | 319,490                 | 982,629                             | 143,956                             |
| Finished goods                    | 10,161,959              | 5,968,530                           | 874,395                             |
| Total inventories                 | ¥ 10,710,018            | ¥ 12,951,275                        | \$ 1,897,372                        |

**NOTE 5. PROPERTY AND EQUIPMENT**

Property and equipment are stated at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows:

|                       |           |
|-----------------------|-----------|
| Motor vehicles        | 10 Years  |
| Office equipment      | 2-5 Years |
| Leasehold improvement | 5 years   |

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Gain or loss on the sales or retirements is included in the consolidated statements of operations. Accumulated depreciation expense was ¥1,006,761 (\$147,398) and ¥993,029 (\$145,473) as at June 30, 2009 and December 31, 2009, respectively. Property and equipment consisted of the following at June 30, 2009 and December 31, 2009:

|                                | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|--------------------------------|-------------------------|-------------------------------------|-------------------------------------|
|                                | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| Motor vehicles                 | ¥ 1,464,918             | ¥ 1,544,114                         | \$ 226,214                          |
| Office equipment and fixtures  | 779,257                 | 541,543                             | 79,336                              |
| Leasehold improvement          | 169,462                 | 276,938                             | 40,572                              |
| Total property and equipment   | 2,413,637               | 2,362,595                           | 346,122                             |
| Less: Accumulated depreciation | (1,006,761)             | (993,029)                           | (145,480)                           |
| Property and equipment, net    | ¥ 1,406,876             | ¥ 1,369,566                         | \$ 200,643                          |

**NOTE 6. SHAREHOLDERS EQUITY**

**Ordinary Shares** - When the Company was incorporated in Cayman Islands on August 21, 2007, 25,000,000 ordinary shares were authorized, and 2,139,203 ordinary shares were issued to the Principal Shareholders, at a par value of \$0.0185 each. On July 29, 2009, the Company completed its IPO by offering 1,700,000 ordinary shares at \$6.00 per share as discussed in Note 13. After this IPO, all the 112,608 redeemable ordinary shares outstanding were automatically converted into non-redeemable ordinary shares pursuant to the Agreement.

**Statutory Reserves** - According to the Articles of Incorporation, the Company is required to transfer a certain portion of its net profit, as determined under PRC accounting regulations, from current net income to the statutory reserve fund. As of June 30, 2009 and December 31, 2009 the balance of total statutory reserves was ¥1,687,772 and ¥2,926,830 (\$428,764).

**Redeemable Ordinary Shares** - On December 10, 2007, the Company signed an Ordinary Shares Subscription Agreement (the Agreement) to sell 112,608 ordinary shares to an investor at an aggregate consideration of \$200,000. Net total proceeds of \$200,000 were received by the Company during March and April, 2008.

The ordinary shares issued are subject to redemption under certain conditions. In the event that the Company fails to list on a recognized stock exchange or complete a qualified IPO within 18 months after the signature of the Agreement, the Company shall repay all the consideration plus 5% of the consideration per annum to the investor. The three Principal Shareholders, Nanjing Recon, ENI, and BHD severally and jointly guaranteed the payment.

**Table of Contents**

**RECON TECHNOLOGY, LTD**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The shares issued are only conditionally redeemable as described above and are therefore not classified as a liability. However, redemption of the shares is not solely within the control of the Company; therefore, the shares are classified outside of permanent equity. As discussed in Note 13, upon the completion of the IPO in July 2009, all the 112,608 redeemable ordinary shares outstanding were automatically converted into non-redeemable ordinary shares pursuant to the Agreement.

**Share-based Awards Plan** - In June 2009, the Board of Directors and the shareholders of the Company adopted the 2009 Stock Incentive Plan (the 2009 Plan ). The 2009 Plan provides for the granting of share options and restricted ordinary shares to employees, non-employee directors and consultants of the Company. Options granted under the 2009 Plan may be Incentive Stock Options or Non-statutory Stock Options. Non-employee directors and Consultants are not eligible to receive the award of an Incentive Stock Option. The Compensation Committee of the Board is entitled to establish the term, vesting conditions and exercise price of the options as well as the vesting conditions and transferability of restricted shares. Under the 2009 Plan, 790,362 unissued ordinary shares have been reserved for issuance. As discussed in Note 13, under the 2009 Plan, the Company granted options to purchase 293,000 ordinary shares to its employees and non-employee directors on July 29, 2009.

**NOTE 7. INCOME TAXES**

The Company is not subject to any income taxes in the United States or the Cayman Islands and had minimal operations in jurisdictions other than the PRC. ENI, BHD and Nanjing Recon are subject to PRC s income taxes as PRC domestic companies. Before the implementation of the new Enterprise Income Tax Law ( EIT Law ), PRC domestic companies are generally subject to an enterprise income tax ( EIT ) rate of 33.0%. On March 16, 2007, the National People s Congress of China passed the new EIT Law, and on December 6, 2007, the State Council of China passed the Implementing Rules for the EIT Law ( Implementing Rules ) which took effect on January 1, 2008. The new amended EIT Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. As a result, income tax rate for BHD and ENI was reduced from 33% to 25% in calendar year 2008 and after.

As approved by the local tax authority in the PRC, Nanjing Recon was entitled to a tax holiday with 50% tax exemption for calendar year 2006 and 2007. Nanjing Recon is also a government-certified high technology company and is subject to an income tax rate of 15%. As a result, Nanjing Recon was subject to an income tax rate of 7.5% for calendar year 2007 and 15% for calendar year 2008 and after.

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Deferred taxes are comprised of the following:

|   | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|---|-------------------------|-------------------------------------|-------------------------------------|
|   | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| Allowance for doubtful receivables                  | ¥ 913,943               | ¥ 572,685                           | \$ 83,899                           |
| Deferred revenue and cost recognition in tax return | (3,901,616)             | (7,483,891)                         | (1,096,396)                         |
| Loss carryforward                                   | 622,448                 | 622,448                             | 91,189                              |
| Total deferred income tax assets (liabilities)      | ¥ (2,365,225)           | ¥ (6,288,758)                       | \$ (921,308)                        |

Following is a reconciliation of income taxes at the calculated statutory rates:

|   | Chinese Yuan (Renminbi)<br>For the Six months Ended<br>December 31, |                     | U.S. Dollars<br>For the Six months Ended<br>December 31, |
|---|---|---------------------|--|
|   | 2008<br>(Unaudited)   | 2009<br>(Unaudited) | 2009<br>(Unaudited)                                      |
| Income tax calculated at statutory rates                | ¥ 3,251,109   | ¥ 5,760,633         | \$ 843,938   |
| Benefit of favorable rate for high-technology companies |   | (653,869)           | (95,792)   |
| Provision for income taxes                              | ¥ 3,251,109   | ¥ 5,106,765         | \$ 748,145   |

The provision for income taxes is comprised of the following:

|                            | Chinese Yuan (Renminbi)<br>For the Six months Ended<br>December 31, |                     | U.S. Dollars<br>For the Six months Ended<br>December 31, |
|----------------------------|---|---------------------|--|
|                            | 2008<br>(Unaudited)   | 2009<br>(Unaudited) | 2009<br>(Unaudited)                                      |
| Current income taxes       | ¥ 3,251,109   | ¥ 1,186,406         | \$ 173,809   |
| Deferred income taxes      |   | 3,920,358           | 574,336  |
| Provision for income taxes | ¥ 3,251,109   | ¥ 5,106,765         | \$ 748,145   |

**NOTE 8. NOTES PAYABLE**

Notes payable consist of the following:

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|  | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|--|-------------------------|-------------------------------------|-------------------------------------|
|  | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| <b>Short-term notes payable due to non-related parties</b>               |                         |                                     |                                     |
| Due-on-demand note payable, no interest                                  | ¥ 1,374,888             | ¥ 1,374,888                         | \$ 201,422                          |
| Short-term note payable, no interest, matures on<br>December 31, 2010    | 193,504                 |                                     |                                     |
| Short-term notes payable, interest at 6%, matures on<br>December 9, 2010 | 625,400                 | 1,172,911                           | 171,832                             |
| Short-term note payable, no interest, matures on<br>December 31, 2010    | 300,000                 | 939,500                             | 137,638                             |
| Short-term note payable, no interest, matures on<br>May 10, 2010         | 650,000                 | 449,500                             | 65,852                              |
| <b>Total short-term notes payable due to non-related parties</b>         | <b>¥ 3,143,792</b>      | <b>¥ 3,936,799</b>                  | <b>\$ 576,744</b>                   |

F-19

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

|   | Chinese Yuan (Renminbi) |                                     | U.S. Dollars                        |
|---|-------------------------|-------------------------------------|-------------------------------------|
|   | June 30,<br>2009        | December 31,<br>2009<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| <b>Short-term notes payable due to related parties:</b>   |                         |                                     |                                     |
| Due-on-demand note payable to Principal Shareholders, no interest   | ¥ 376,377               | ¥ 406,995                           | \$ 59,625                           |
| Short-term note payable to a Principal Shareholder's family member, interest at 6%, matures on May 5, 2010      | 182,000                 | 249,100                             | 36,493                              |
| Short-term note payable to a Principal Shareholder's family member, interest at 6%, matures on December 9, 2010 | 53,000                  | 350,000                             | 51,275                              |
| Short-term note payable to management, interest at 6%, matures on December 9, 2010                              | 583,000                 | 717,980                             | 105,185                             |
| <b>Total short-term notes payable due to related parties</b>  | <b>¥ 3,344,377</b>      | <b>¥ 1,724,075</b>                  | <b>\$ 252,578</b>                   |

**NOTE 9. CONCENTRATIONS**

For the six month ended December 31, 2008, the Company's two largest customers accounted for approximately 59% and 33% of its revenue. For the six months ended December 31, 2009, the largest two customers represented about 58.27% and 21.77% of the Company's revenue. For the period ended December 31, 2009, no supplier accounted 10% of its cost of revenue.

**NOTE 10. COMMITMENTS AND CONTINGENCIES**

The Company leases offices in Beijing, Nanjing and Shandong. The amount of commitments for non-cancelable operating leases for remaining quarters of 2010 is ¥64,800 (\$9,493). All the lease agreements expire in 2010.

**NOTE 11. RELATED PARTY TRANSACTIONS**

**Receivables from related parties** - At June 30, 2009 and December 31, 2009, the Company had net trade receivables from related parties of ¥7,458,302 (\$1,091,960) and ¥19,048,800 (\$2,790,542), respectively, for the sale of goods to related parties and net other receivables from related parties of ¥507,541 (\$74,308) and ¥116,615 (\$17,083), respectively.

**Payables to related parties** - At June 30, 2009 and December 31, 2009, the Company owed related parties ¥189,744 (\$27,780) and ¥85,876 (\$12,580), respectively, for the purchase of goods. The Company also had other payables to related parties of ¥ 73,579 (\$10,773) and ¥375,300(\$54,979), respectively, due to Principal Shareholders and companies under common ownership for payments of expenses made on behalf of the Company.

**Leases from related parties** - On January 1, 2009, the Company entered into a one-year agreement with Mr. Chen Guangqiang for the lease of office space. The terms of the agreement state that the Company will lease the property for one year, and pay Mr. Chen Guangqiang ¥4,500 per month.



**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company also rents office space from Mr. Yin Shenping's wife. The Company pays ¥15,000 per month to Mr. Yin Shenping's wife for its use.

**NOTE 12. DISCONTINUED OPERATIONS**

In 2008, the Company completed the sale of Xiamen Hengda Haitian and Beijing Yabei Nuoda. Both Xiamen Hengda Haitian and Yabei Nuoda were previously controlled by one of our principle shareholders. The Company determined that these two subsidiaries met the criteria for classification as discontinued operations in the first quarter of fiscal year 2008. The financial results associated with the two subsidiaries for the period ended December 31, 2008 are included in discontinued operations.

Summarized Statements of Income data for discontinued operations is as follows:

|   | Chinese Yuan (Renminbi)<br>For the Six months Ended<br>December 31, 2008 2009 |             | U.S. Dollars<br>For the Six months Ended<br>December 31, 2009 |
|---|---|-------------|---|
|   | (Unaudited)   | (Unaudited) | (Unaudited)   |
| Revenue   | ¥ 3,495,001   | ¥           | \$  |
| Income(loss) before provision for income tax    | (442,547)   |             |   |
| Provision for income tax                        |   |             |   |
| Income from discontinued operations, net of tax | ¥ (442,547)   | ¥           | \$  |

**NOTE 13. STOCK-BASED COMPENSATION**

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123-R, Share-Based Payment (SFAS No. 123-R) (ASC 718), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including stock options based on their fair values. SFAS No. 123-R supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), which the Company previously followed in accounting for stock-based awards. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) (ASC 718) to provide guidance on SFAS No. 123-R. The Company has applied SAB 107 in its adoption of SFAS No. 123-R.

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Statement No. 123(R) requires companies to record compensation expense for stock options measured at fair value, on the date of grant, using an option-pricing model. The fair value of stock options is determined using the Binomial Lattice valuation model instead of the Black-Scholes Model previously utilized under Statement No. 123. The Company believes that the revised model represents a more likely projection of actual outcomes.

Statement No. 123(R) requires that the realized tax benefit related to the excess of the deductible amount over the compensation expense recognized be reported as a financing cash flow rather than as an operating cash flow, as required under previous accounting guidance. The Company does not recognize any tax benefit related to this based on the Company's historical operating performance, lack of taxable income and the accumulated deficit.

As of December 31, 2009, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's option plans.

**Share-based Payments** - As discussed in Note 6, the Company granted options to purchase 293,000 ordinary shares under the 2009 Plan to its employees and non-employee directors on July 29, 2009. The options have an exercise price of \$6.00 equal to the IPO price of the Company and will be vested over a period of five years, with the first 20% vesting on July 29, 2010. The options will expire ten years after the date of grant, on July 28, 2019. For the six months ended December 31, 2009, the fair value were estimated using the Binomial Lattice valuation model, with the following weighted-average assumptions and fair values as follows:

|  | <b>Six Months Ended<br/>December 31,<br/>2009</b> |
|--|---|
| Volatility (percent)*                          | 78  |
| Life of option (year)**                        | 10  |
| Risk free interest rate (percent)***           | 4.6118  |
| Expected dividend rate (percent)               |   |
| Forfeiture rate (percent)****                  | 15  |
| Weighted-average fair value per option granted | 4.4166  |

\* Volatility is projected using the performance of PHLX Oil Service Sector index.

\*\* The life of options represents the period the option is expected to be outstanding.

\*\*\* The risk-free interest rate is based on the Chinese international bond denominated in U.S dollar with a maturity that approximates the life of the option.

\*\*\*\* Forfeiture rate is the estimated percentage of options forfeited by employees by leaving or being terminated before vesting.

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The grant date fair value of the options was ¥30.17. Compensation expense recorded for the six months ended December 31, 2009 was ¥736,688 (\$107,838).

**Placement Agent Warrants** - As discussed in Note 6, the Company completed its IPO offering on July 31, 2009, and the gross proceeds received by the Company for the Offering were \$10,200,000 (1,700,000 ordinary shares at \$6.00 per share) before the cash offering costs of ¥9,651,771 (\$1,412,896).

In connection with the Offering, the Company sold the placement agent warrants to purchase 170,000 ordinary shares at \$7.20 per share for a nominal amount. These warrants are exercisable for a period of five years. The Company has agreed to file, during the five year period at its cost, at the request of the holders of a majority of the placement agents warrants and the underlying ordinary shares, and to use its best efforts to cause to become effective a registration statement under the Securities Act, as required to permit the public sale of ordinary shares issued or issuable upon exercise of the placement agent s warrants. The Company accounted for the warrants as an additional offering cost with an estimated value of \$627,341. The following table presents the assumptions used in Black-Scholes valuation model to estimate the fair values of the placement agent warrants sold:

|                          |       |
|--------------------------|-------|
| Risk-free interest rate  | 3.77% |
| Dividend yield           | 0%    |
| Expected volatility      | 78%   |
| Expected life (in years) | 5     |

On July 31, 2009 ordinary shares of the Company commenced trading on NASDAQ Exchange. The Company has 3,951,811 ordinary shares issued and outstanding at July 31, 2009.

The Company had 293,000 of granted stock options that were exercisable as of December 31, 2009 and zero of granted stock options as of December 31, 2008. The Company had 170,000 of granted placement agent warrants as of December 31, 2009 and zero of warrants as of December 31, 2008.

**NOTE 14 EARNINGS PER SHARE.**

Statement of Financial Accounting Standards No. 128 (ASC Topic 260), *Earnings per share* requires the presentation of basic earnings per share and diluted earnings per share. Basic and diluted earnings per share computations are presented by the Company conform to the standard and are based on the weighted average number of shares of Common Stock outstanding during the year.

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Basic earnings per share are computed by dividing net income or loss by the weighted average number of shares outstanding for the year.

Diluted earnings per share is computed by dividing net income or loss by the total of the weighted average number of shares outstanding, and the dilutive effect of outstanding stock options (applying the treasury stock method).

According to the share subscription agreement signed on December 10, 2007, if the company completes an initial public offering of its common stock on or before September 30, 2009, the founder's obligation to purchase, and the investor's obligation to sell, the shares shall terminate automatically and immediately. So the company's 112,608 redeemable ordinary shares are currently included in the calculation of the basic EPS and there are no more redeemable shares.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

|   | For the Six Months Ended<br>December 31, |                     | For the Six Months Ended            |
|---|--|---------------------|-------------------------------------|
|   | 2009<br>(Unaudited)                      | 2008<br>(Unaudited) | December 31,<br>2009<br>(Unaudited) |
| Basic weighted average ordinary shares outstanding          | 3,656,277                                | 2,139,203           | 3,656,277                           |
| Effect of redeemable ordinary shares                        |  | 112,608             |                                     |
| Effect of Share-based Payments and Placement Agent Warrants | 42,703                                   |                     | 42,703                              |
| Diluted weighted average ordinary shares outstanding        | 3,698,981                                | 2,251,811           | 3,698,981                           |
| <b>Net income from continuing operations</b>                | ¥ 14,649,512                             | ¥ 10,421,797        | \$ 2,146,166                        |
| Basic earning per share                                     | ¥ 4.01                                   | ¥ 4.87              | \$ 0.59                             |
| Diluted earnings per share                                  | ¥ 3.96                                   | ¥ 4.63              | \$ 0.58                             |
| <b>Income from discontinued operations</b>                  | ¥  | ¥ (442,547)         | \$                                  |
| Basic earning per share                                     | ¥  | ¥ (0.21)            | \$                                  |
| Diluted earnings per share                                  | ¥  | ¥ (0.20)            | \$                                  |
| <b>Net income available for common shareholders</b>         | ¥ 12,978,572                             | ¥ 8,826,541         | \$ 1,901,372                        |
| Basic earnings per share                                    | ¥ 3.55                                   | ¥ 4.13              | \$ 0.52                             |
| Diluted earnings per share                                  | ¥ 3.51                                   | ¥ 3.92              | \$ 0.51                             |

**NOTE 15. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION**

**Basis of presentation** - For the purpose of presenting parent company only condensed financial information, the Company recorded its interest in subsidiaries and variable interest entities under the equity method of accounting in the condensed balance sheets and reported its share of the profit (loss) of its subsidiaries and variable entities as equity in (profit) loss of subsidiaries and variable interest entities in the condensed statements of operations. These parent-company-only financial statements should be read in conjunction with the Company's consolidated financial statements.

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

|  | Chinese Yuan (Renminbi) |                               | U.S. Dollars                   |
|--|-------------------------|-------------------------------|--------------------------------|
|  | 30-Jun<br>2009          | 31-Dec<br>2009<br>(Unaudited) | Dec 31,<br>2009<br>(Unaudited) |
| <b>ASSETS</b>  |                         |                               |                                |
| Cash and cash equivalents  | ¥ 22                    | ¥ 42,301,666                  | \$ 6,197,229                   |
| Receivables from a subsidiary  | 1,373,487               | 15,378,968                    | 2,253,032                      |
| Other receivable   |                         | 26,196                        | 3,838                          |
| Prepaid expenses   |                         | 721,144                       | 105,648                        |
| Interests in subsidiaries and variable interest entities   | 28,844,818              | 44,798,843                    | 6,563,068                      |
| <b>Total assets</b>  | <b>¥ 30,218,327</b>     | <b>¥ 103,226,817</b>          | <b>\$ 15,122,814</b>           |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                         |                               |                                |
| <b>Current liabilities</b>   |                         |                               |                                |
| Other payable  | ¥                       | ¥ 103,866                     | \$ 15,216                      |
| Payable to a subsidiary  |                         | 1,640,502                     | 240,335                        |
| Other payable - related parties  | 19,721                  | 26,418                        | 3,870                          |
| <b>Total current Liabilities</b>   | <b>19,721</b>           | <b>1,770,786</b>              | <b>259,422</b>                 |
| <b>Redeemable ordinary shares</b>  | <b>1,434,342</b>        |                               |                                |
| <b>Shareholders equity</b>   |                         |                               |                                |
| Ordinary shares, \$0.0185 U.S. dollar par value, 25,000,000 shares authorized and 2,139,203 shares outstanding | 300,534                 | 529,637                       | 77,592                         |
| Additional paid-in capital   | 8,732,266               | 68,292,476                    | 10,004,904                     |
| Statutory reserves   | 1,687,772               | 2,926,830                     | 428,783                        |
| Retained earnings  | 18,043,692              | 29,762,625                    | 4,360,249                      |
| Other comprehensive income   |                         | (55,536)                      | (8,136)                        |
| <b>Total shareholders equity</b>   | <b>28,764,264</b>       | <b>101,456,031</b>            | <b>14,863,393</b>              |
| <b>Total liabilities and shareholders equity</b>   | <b>¥ 30,218,327</b>     | <b>¥ 103,226,817</b>          | <b>\$ 15,122,814</b>           |
| <b>Income Statement</b>  |                         |                               |                                |
|  | Chinese Yuan (Renminbi) |                               | U.S. Dollars                   |
|  | For 6 months Ended      |                               | For the Six Months Ended       |
|  | December 31,            |                               | June 30, 2009                  |
|  | 2008                    | 2009                          | 2009                           |
|  | (Unaudited)             | (Unaudited)                   | (Unaudited)                    |
| General, administrative and selling expense  | ¥ (822,808)             | ¥ (2,988,686)                 | \$ (437,845)                   |
| Other income (expenses)  |                         |                               |                                |
| <b>Operating loss</b>  | <b>(822,808)</b>        | <b>(2,988,686)</b>            | <b>(437,845)</b>               |
| Profit from variable interest entities and subsidiaries  | 9,401,398               | 15,974,611                    | 2,340,294                      |
| Interest income  | 822                     | (7,353)                       | (1,077)                        |
| Net income   | 9,402,220               | 12,978,572                    | 1,901,372                      |
| Dividends on redeemable ordinary shares  |                         |                               |                                |

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|   |             |              |              |
|---|-------------|--------------|--------------|
| <b>Net Income available for common shareholders</b> | ¥ 9,402,220 | ¥ 12,978,572 | \$ 1,901,372 |
|---|-------------|--------------|--------------|

F-25

**Table of Contents****RECON TECHNOLOGY, LTD****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

|   | Chinese Yuan (Renminbi)              |              | U.S. Dollars                             |
|---|--------------------------------------|--------------|--|
|   | For Six Months Ended<br>December 31, |              | For the Six Months ended<br>December 31, |
|   | 2008                                 | 2009         | 2009                                     |
|   | (Unaudited)                          | (Unaudited)  | (Unaudited)                              |
| <b>Cash flows from operating activities:</b>          |                                      |              |  |
| Net income available for common shareholders          | ¥ 9,402,220                          | ¥ 12,978,572 | \$ 1,901,372                             |
| variable interest entities                            | (9,401,398)                          | (15,974,611) | (2,340,294)                              |
| Share-based payment                                   |                                      | 736,688      |  |
| <b>Changes in current assets and liabilities</b>      |                                      |              |  |
| Receivables from a subsidiary                         |                                      | (14,005,481) | (2,051,815)                              |
| Other receivable                                      |                                      | (26,196)     | (3,838)                                  |
| Prepaid expense                                       |                                      | (721,143)    | (105,648)                                |
| Interest payable                                      | (822)                                |              |  |
| Other payable   |                                      | (839,864)    |  |
| <b>Net cash used in operating activities</b>          |                                      | (17,852,035) | (2,600,223)                              |
| <b>Cash flows from financing activities:</b>          |                                      |              |  |
| Proceeds from issuance of ordinary shares             |                                      | 60,209,057   | 8,820,677                                |
| <b>Net cash provided by financing activities</b>      |                                      | 60,209,057   | 8,820,677                                |
| Effect of foreign exchange rate fluctuation           |                                      | (55,378)     | (8,113)                                  |
| <b>Net change in cash</b>                             |                                      | 42,301,644   | 6,197,226                                |
| <b>Cash and cash equivalents at beginning of year</b> | 22                                   | 22           | 3  |
| <b>Cash and cash equivalents at end of year</b>       | ¥ 22                                 | ¥ 42,301,666 | \$ 6,197,229                             |