Sino Clean Energy Inc
Form 10-Q
May 15, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended March 31, 2012

or

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from to .

Commission File Number 001-34773

SINO CLEAN ENERGY INC.

(Exact name of registrant as specified in its charter)

Nevada 75-2882833

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

Room 1502, Building D, Wangzuo International City Building

No. 3 Tangyuan Road, Gaoxin District

Xi'an, Shaanxi Province, People's Republic of China

(Address of Principal Executive Offices Including Zip Code)

+86 29 8844-7960

(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 Exchange Act 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 þ 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 þ No ¨

Indicate by check mark if 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 þ

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

Yes ¨ No þ

As of May 13, 2012, 23,863,701 shares of the issuer’s common stock, par value $0.001, were outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Sino Clean Energy Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	March 31, 2012 (unaudited)	December 31, 2011
ASSETS		
Cash and cash equivalents	$66,492,750	$42,431,330
Accounts receivable, net	12,967,753	13,191,545
Inventories	1,925,860	1,288,599
Prepaid inventories	18,891,673	37,057,551
Prepaid expenses	76,684	26,510
Land use right – current portion	83,812	82,954
Total current assets	100,438,532	94,078,489
Land use right – non-current portion	5,494,655	5,467,517
Property, plant and equipment, net	17,560,096	18,110,321
Deposits on property, plant and equipment	6,332,451	6,267,514
Goodwill	762,018	762,018
Total assets	$130,587,752	$124,685,859
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable and accrued expenses	$1,965,089	$1,988,263
Taxes payable	2,601,407	2,596,227
Amount due to directors	198,409	48,457
Derivative liabilities	2,407,076	729,740
Total liabilities	7,171,981	5,362,687
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, $0.001 par value, 50,000,000 shares authorized None issued and outstanding		
Common stock, $0.001 par value, 30,000,000 shares authorized, 23,863,701 issued and outstanding as of March 31, 2012 and December 31, 2011 respectively	23,841	23,841

Additional paid-in capital	67,291,387	67,291,387
Treasury stock, at cost, 321,100 shares	(799,423)	(799,423)
Retained earnings	42,300,033	39,520,369
Statutory reserves	6,565,521	6,565,521
Accumulated other comprehensive income	8,034,412	6,721,477
Total shareholders’ equity	123,415,771	119,323,172
Total liabilities and shareholders’ equity	$130,587,752	$124,685,859

See accompanying notes to the condensed consolidated financial statements

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Sino Clean Energy Inc. and Subsidiaries

Condensed Consolidated Statements of Income and Other Comprehensive Income

(Unaudited)

	Three months ended March 31,	
	2012	2011
Revenue	$ 27,831,694	$ 33,780,732
Cost of goods sold	(19,298,230)	(21,281,408)
Gross profit	8,533,464	12,499,324
Selling expenses	1,212,838	1,527,466
General and administrative expenses	1,290,073	1,031,542
Income from operations	6,030,553	9,940,316
Other income (expense)		
Interest income	65,569	44,187
Change in fair value of derivative liabilities	(1,677,336)	4,010,630
Total other (expense) income	(1,611,767)	4,054,817
Income before provision for income taxes	4,418,786	13,995,133
Provision for income taxes	1,639,122	1,915,380
Net income	2,779,664	12,079,753
Other comprehensive income		
Foreign currency translation adjustment	1,312,935	918,229
Comprehensive income	$ 4,092,599	$ 12,997,982
Weighted average number of shares		
-Basic	23,863,701	23,465,794
-Diluted	23,877,337	25,381,392
Income (loss) per common share		
- Basic	$ 0.12	$ 0.51
- Diluted	$ 0.12	$ 0.48

See accompanying notes to the condensed consolidated financial statements

Sino Clean Energy Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	$ 2,779,664	$ 12,079,753
Adjustments to reconcile net income to cash provided by operating activities :		
Depreciation and amortization	769,153	735,857
Change in fair value of derivative liabilities	1,677,336	(4,010,630)
Change in operating assets and liabilities :		
- Accounts receivable	87,116	(4,592,187)
- Inventories	(650,612)	(1,432,356)
- Prepaid inventories	17,781,929	2,951,225
- Prepaid expenses	(50,449)	6,871
- Accounts payable and accrued expenses	(2,574)	(370,299)
- Taxes payable	32,079	(312,674)
Net cash provided by operating activities	22,423,642	5,055,560
Cash flows from investing activities:		
Payable on plant acquisition	-	2,318,540
Repayment from related party- Suo’ang BST	-	10,639,915
Purchase of property, plant and equipment	-	(47,751)
Net cash provided by investing activities	-	12,910,704
Cash flows from financing activities:		
Cash advance from a director	149,950	-
Cash received from exercise of warrants	-	34,200
Repayment of mortgage payable	-	(1,344)
Net cash provided by financing activities	149,950	32,856
Effect of foreign currency translation	1,487,828	300,193
Net increase in cash and cash equivalents	24,061,420	18,299,313
Cash and cash equivalents, beginning of period	42,431,330	52,055,857
Cash and cash equivalents, end of period	$ 66,492,750	$ 70,355,170
Supplemental Disclosure Information:		
Cash paid for taxes	$ 1,633,942	$ 2,127,983
Supplemental non-cash investing and financing activities:		
Deposits applied to purchase of land use rights, property, plant and equipment	$ -	$ 9,409,091

See accompanying notes to the condensed consolidated financial statements

Sino Clean Energy Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

For the three months ended March 31, 2012 and 2011

1. ORGANIZATION AND BUSINESS ACTIVITIES

Overview

Sino Clean Energy Inc. (sometimes referred to as the “Company”, “we” or “our”) is a holding company that, through its subsidiaries, is a leading third party commercial producer and distributor of coal-water slurry fuel (“CWSF”) in China. CWSF is a clean fuel that consists of fine coal particles suspended in water. Our CWSF products are mainly used to fuel boilers and furnaces to generate steam and heat for residential and industrial applications. We sell our products in China and our customers include industrial, commercial, residential and government organizations. Our strong reputation in the CWSF industry in China, together with our established track record for consistently delivering products in large quantities, has enabled us to expand our customer base. We primarily use washed coal to produce CWSF. We acquire the raw materials for each of our production facilities primarily from nearby coal mines. We have established strong relationships with our suppliers and our ability to purchase large quantities of raw materials has allowed us to achieve favorable pricing and delivery terms.

Corporate Organization and History

We were originally incorporated in Texas as "Discount Mortgage Services, Inc." on July 11, 2000. In September 2001, we purchased Endo Networks, Inc., a Canadian software developer, and changed our name to "Endo Networks, Inc." on November 5, 2001. We re-domiciled to the State of Nevada on December 13, 2001.

On October 20, 2006 we consummated a share exchange transaction with Hangson, a British Virgin Islands company, the stockholders of Hangson and a majority of our stockholders. We issued a total of 2,600,000 shares of our common stock to the Hangson shareholders and a consultant in the transaction, in exchange for 100% of the common stock of Hangson. Hangson was a holding company that controlled Suo'ang BST and Suo'ang BST's 80%-owned subsidiary Suo'ang New Energy, through a series of contractual arrangements. The remaining 20% of Suo'ang New Energy was owned by Mr. Peng Zhou, a member of our board of directors and, at that time, the chief operating officer of Suo'ang BST. Suo'ang BST, through Suo'ang New Energy, commenced CWSF production in July 2007. Although Hangson was entitled to acquire the remaining 20% of Suo'ang New Energy from Mr. Zhou, the transfer was not completed and Mr. Zhou remained as the record shareholder of Suo'ang New Energy. As a result of the share exchange, we became engaged in the CWSF business, through the operations of Suo'ang BST and Shaanxi Suo'ang New Energy. On January 4, 2007, we changed our name from "Endo Networks, Inc." to "China West Coal Energy Inc.", and then on August 15, 2007, we changed our name again to our present name, Sino Clean Energy Inc.

We reorganized our corporate structure in 2009. In June 2009, we acquired 100% of Wiscon, which established Suoke Clean Energy, the Company's wholly foreign-owned enterprise, in Tongchuan, Shaanxi Province. We subsequently entered into a series of agreements transferring all of the rights and obligations of Hangson under the contractual arrangements with Suo'ang BST to Suoke Clean Energy. In November 2009, Suoke Clean Energy duly entered into an equity transfer agreement with former shareholders of Suo'ang New Energy, pursuant to which 100% equity interests of Suo’ang New Energy was transferred to Suoke Clean Energy and such acquisition was approved by the government authority, Tongchuan Administration for Industry and Commerce. On May 14, 2010, Tongchuan Administration for Industry and Commerce also issued a proof showing all registration for acquisition was completed. All transaction documents and governmental process for acquisition, therefore, has been completed. The entity that entered into contractual arrangement with the Company is Suo'ang BST rather than Suo’ang New Energy. The Company terminated contractual arrangement with Suo’ang BST on December 31, 2009.

In connection with this termination, certain assets held by Suo'ang BST, such as office equipment, vehicles, bank deposits and accounts receivable, were transferred to Suoke Clean Energy. Employees of Suo'ang BST signed new employment contracts with Suoke Clean Energy and rights and obligations under certain remaining business operation agreements, and research and development contracts between Suo'ang BST and third parties, were assigned to Suo'ang New Energy. Hangson transferred all of its equity interests in Wiscon to us. There was no cash or new shares of common stock issued by the Company for the above transactions and the Company accounted for the above transactions as the transfer of assets or equity interests between entities under common control, with no change in the basis of assets or liabilities transferred between the entities under common control.

On October 12, 2009, Suo’ang New Energy established Shenyang Sou’ang Energy Co., Ltd., a wholly-owned PRC subsidiary (“Shenyang Energy”), to conduct the CWSF business in Shenyang, Liaoning province. In August 2010, the Company acquired all the outstanding capital stock of Dongguan Clean Energy Water Coal Mixture Company (“Dongguan Clean Energy”). At the time, the assets and liabilities of Dongguan Clean Energy consisted primarily of a business license to manufacture and distribute CWSF in Dongguan, Guangdong, which the Company began to use in January 2011.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation and consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The financial statements contained herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2011 Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed with the SEC. The results of operations for interim periods are not necessarily indicative of the results expected for a full year or for any future period.

The condensed consolidated financial statements include the financial statements of the Company, its wholly owned subsidiaries Wiscon, Tongchuan Suoke Clean Energy, Shaanxi Suo’ang New Energy, Shenyang Suo’ang New Energy and Dongguan Clean Energy Water Coal Mixture Company. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates. Those estimates and assumptions include estimates for allowance for doubtful accounts, inventory and prepaid inventory valuation, impairment considerations, and assumptions used in the valuation of derivative liabilities.

Revenue Recognition

Revenues of the Company are from sales of CWSF. Sales are recognized when the following four revenue criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured. Revenues are presented net of value added tax (“VAT”). In our revenue arrangements, physical delivery is the point in time when customer acceptance occurs since title and risk of loss are transferred to the customer. No return allowance is made as products are not returnable upon acceptance by the customers. For the three-month period ended March 31, 2012 and 2011, revenue was $27,831,694 and $33,780,732 respectively.

Cost of goods sold

Expenses which comprise cost of goods sold are the direct cost of raw materials (coal, ferrous sulfate, and coal water mixture chemicals), the costs incurred to get the raw materials to our production plants, salaries of production workers, electricity use for production equipment, water used for production, and manufacturing overhead. Manufacturing overhead includes materials, depreciation and amortization related to property, plant, and equipment used directly in production of inventory, rent related to plants used directly in the production of inventory, and other such costs associated with preparing our CWSF for sale. For the three-month period ended March 31, 2012 and 2011, cost of goods sold was $19,298,230 and $21,281,408 respectively.

Transportation costs

Transportation costs consist mostly of fees paid to third party logistic companies. In 2009 and years prior, transportation cost were paid mostly by our customers. During the year ended 2010, the Company re-negotiated our annual contracts with all customers (including customers of the Tongchuan and Shenyang facilities), and we became responsible for paying the transportation costs. As part of the re-negotiated contracts, selling prices were adjusted upward to offset the transportation expenses now being paid by the Company.

Transportation cost is not directly related to the production of our CWSF, rather, it occurs when our product is sold to our customers. This cost represents a variable in the selling price since it will be adjusted to reflect the distance of the transported product, which is customer-specific. As a result, we classify the transportation costs as selling expenses and do not include it in the cost of goods sold.

The transportation costs of shipping CWSF to our customers of $1,184,858 (97.6% of the total selling expenses) and $1,500,356 (98.2% of the total selling expenses) for the three-month period ended March 31, 2012 and 2011, respectively are included in selling expenses on the condensed consolidated statements of operations and other comprehensive income.

With respect to our accounting treatment with the transportation costs, our gross profit amounts may not be comparable to those of other entities, since some entities include transportation costs in cost of goods sold and others like us exclude a portion of them from gross profit.

Fair value of financial instruments

Fair value measurements are determined using authoritative guidance issued by the FASB, with the exception of the application of the guidance to non-recurring, non-financial assets and liabilities as permitted. Fair value is defined in the authoritative guidance as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy was established, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs, other than the quoted prices in active markets, are observable either directly or indirectly.

Level 3—Unobservable inputs based on the Company's assumptions.

The Company is required to use observable market data if available without undue cost and effort.

The following table presents certain investments and liabilities of the Company's financial assets measured and recorded at fair value on the Company's condensed consolidated balance sheets on a recurring basis and their level within the fair value hierarchy as of March 31, 2012 and December 31, 2011:

	March 31, 2012 (unaudited)			
	Level 1	Level 2	Level 3	Total
Fair value of warrants	$-	$ -	$2,407,076	$2,407,076

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Fair value of warrants	$-	$ -	$729,740	$729,740

The changes in level 3 liabilities measured at fair value on a recurring basis are summarized as follows:

	Fair Value of Warrants
Balance at December 31, 2011	$ 729,740
Fair value adjustment for the three-month period ended March 31, 2012	1,677,336
Balance at March 31, 2012	$ 2,407,076

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Derivative financial instruments

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, the Company uses a Monte-Carlo Simulation of Black-Scholes-Merton option pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Stock based compensation

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board, whereas the value of the award is measured on the date of grant and recognized over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the Financial Accounting Standards Board, whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete. Non-employee stock-based compensation charges generally are amortized over the vesting period on a straight-line basis. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company’s common stock option grant is estimated using the Black-Scholes-Merton option pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the common stock options, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes-Merton option pricing model, and based on actual experience. The assumptions used in the Black-Scholes-Merton option pricing model could materially affect compensation expense recorded in future periods.

Income per common share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The diluted earnings per share calculation give effect to all potentially dilutive common shares outstanding during the year using the treasury stock method for warrants and options. As of March 31, 2012 and 2011, common stock equivalents were composed of options and warrants exercisable into 100,000 and 3,148,581 shares of the Company's common stock, respectively.

	Three months ended March 31,	
	2012	2011
	(unaudited)	(unaudited)
Numerator		
Net income	$ 2,779,664	$ 12,079,753
Denominator		
Weighted average shares outstanding-basic	23,863,701	23,465,794
Effect of dilutive instruments:		
Warrants and options	13,636	1,915,598
Weighted average shares outstanding-diluted	23,877,337	25,381,392

At March 31, 2012 and 2011, warrants and options exercisable into 2,845,885 and 50,000 shares of the Company's common stock respectively, have been excluded from the diluted share calculation as their effect would have been antidilutive.

Foreign currency translation

The accompanying consolidated financial statements are presented in United States dollars. The functional currency of the Company is the Renminbi (“RMB”). Capital accounts of the consolidated financial statements are translated into United States dollars from RMB at their historical exchange rates when the capital transactions occurred. Assets and liabilities are translated at the exchange rate as of the balance sheet date. Income and expenditures are translated at the average exchange rate for the period presented.

	March 31, 2012	December 31, 2011	March 31, 2011
Period end RMB : US$ exchange rate	6.3122	6.3776	6.5483