

CleanTech Innovations, Inc.
Form 10-Q
May 13, 2014

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

Commission file number: 001-35002

CLEANTECH INNOVATIONS, INC.
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of incorporation
or organization)

98-0516425
(IRS Employer Identification No.)

C District, Maoshan Industry Park,
Tieling Economic Development Zone,
Tieling, Liaoning Province, China
(Address of principal executive offices)

112616
(Zip Code)

(86) 0410-6129922
(Registrant's telephone number, including area code)

Indicate by checkmark 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 last 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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a 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: 24,982,822 shares of common stock outstanding as of May 8, 2014.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which include, but are not limited to, statements concerning our projected revenues, expenses, gross profit and income, mix of revenue, demand for our products, the benefits and potential applications for our products, the need for additional capital, our ability to obtain and successfully perform additional new contract awards and the related funding and profitability of such awards, the competitive nature of our business and markets and product qualification requirements of our customers. These forward-looking statements are based on our current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by us. Words such as "anticipates," "expects," "intends," "plans," "predicts," "potential," "believes," "seeks," "hopes," "estimates," "should," "may," "will," "with" variations of these words or similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. Such factors include, but are not limited to the following:

- our goals and strategies;
- our expansion plans;
- our future business development, financial conditions and results of operations;
- the expected growth of the market for structural towers for wind turbine products and specialty metal products;
 - our expectations regarding demand for our products;
- our expectations regarding keeping and strengthening our relationships with key customers;
 - our ability to stay abreast of market trends and technological advances;
- our ability to protect our intellectual property rights effectively and not infringe on the intellectual property rights of others;
 - our ability to attract and retain quality employees;
 - our ability to pursue strategic acquisitions and alliances;
 - competition in our industry in China;
- general economic and business conditions in the regions in which we sell our products;
 - relevant government policies and regulations relating to our industry; and
 - market acceptance of our products.

Additionally, this report contains statistical data that we obtained from various publicly available government publications and industry-specific third party reports. Statistical data in these publications also include projections based on a number of assumptions. The markets for our products may not grow at the rates projected by market data, or at all. The failure of these markets to grow at the projected rates may have a material adverse effect on our business and the market price of our common stock. In addition, the changing nature of our customers' industries results in uncertainties in any projections or estimates relating to the growth prospects or future condition of our markets. Furthermore, if any one or more of the assumptions underlying the market data is later found to be incorrect, actual results may differ from the projections based on these assumptions.

Unless otherwise indicated, information in this report concerning economic conditions and our industry is based on information from independent industry analysts and publications, as well as our estimates. Except where otherwise noted, our estimates are derived from publicly available information released by third party sources, as well as data from our internal research, and are based on such data and our knowledge of our industry, which we believe to be reasonable. None of the market data from independent industry publications cited in this report was prepared on our or our affiliates' behalf.

Additional information on the various risks and uncertainties potentially affecting our operating results are discussed in this report and other documents we file with the Securities and Exchange Commission, or the SEC, or available upon written request to our corporate secretary at C District, Maoshan Industry Park, Tieling Economic Development Zone, Tieling, Liaoning Province, China . We undertake no obligation to revise or update publicly any forward-looking statements for any reason, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on these forward-looking statements.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
MARCH 31, 2014 (UNAUDITED) AND DECEMBER 31, 2013

| | 2014 | 2013 |
|-------------------------------------------------|---------------------|---------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and equivalents | \$414,097 | \$8,178 |
| Restricted cash | - | 244,427 |
| Accounts receivable, net | 2,235,719 | 2,000,914 |
| Other receivables and deposits, net | 2,568,041 | 2,758,253 |
| Retentions receivable, net | 532,603 | 1,051,227 |
| Advances to suppliers, net | 166,291 | 466,878 |
| Inventories, net | 6,467,863 | 6,061,974 |
| Notes receivable | 15,604 | 738,080 |
| Total current assets | 12,400,218 | 13,329,931 |
| NONCURRENT ASSETS: | | |
| Advance for equipment purchase | 351,842 | 336,822 |
| Prepayments | 316,598 | 321,248 |
| Property and equipment, net | 11,595,758 | 11,853,575 |
| Land use right and patents, net | 4,101,536 | 4,162,058 |
| Total non current assets | 16,365,734 | 16,673,703 |
| TOTAL ASSETS | \$28,765,952 | \$30,003,634 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | 2,357,223 | 2,720,996 |
| Accrued expenses and other payables | 4,517,883 | 4,353,402 |
| Advance from customers | 299,197 | 243,171 |
| Advances from shareholder | 929,679 | - |
| Tax payable | 63,233 | 68,234 |
| Short term loans | 10,688,951 | 12,952,396 |
| Short term payable, net of unamortized interest | 453,992 | 442,827 |
| Total current liabilities | 19,310,158 | 20,781,026 |
| Total Liabilities | 19,310,158 | 20,781,026 |
| CONTINGENCIES AND COMMITMENTS | | |

STOCKHOLDERS' EQUITY:

| | | |
|------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| Preferred stock, \$0.00001 par value, 100,000,000 shares authorized, no shares issued and outstanding | - | - |
| Common stock, \$0.00001 par value, 100,000,000 shares authorized, 24,982,822 shares issued and outstanding | 250 | 250 |
| Additional paid in capital | 20,649,092 | 20,649,092 |
| Statutory reserve fund | 1,104,138 | 1,104,138 |
| Accumulated other comprehensive income | 3,888,194 | 4,105,963 |
| Accumulated deficit | (16,185,880) | (16,636,835) |
| Total stockholders' equity | 9,455,794 | 9,222,608 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$28,765,952 | \$30,003,634 |

The accompanying notes are an integral part of these financial statements.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(UNAUDITED)

| | Three months ended March 31, | |
|-------------------------------------------------------|------------------------------|--------------|
| | 2014 | 2013 |
| Net sales | \$1,927,593 | \$252,819 |
| Cost of goods sold | 1,538,078 | 430,101 |
| Gross profit (loss) | 389,515 | (177,282) |
| Operating expenses | | |
| Selling | 43,402 | 48,488 |
| General and administrative | 328,026 | 238,704 |
| Reverse of bad debt allowance | (709,595) | - |
| Total operating expenses (income) | (338,167) | 287,192 |
| Income (loss) from operations | 727,682 | (464,474) |
| Non-operating income (expenses) | | |
| Interest income | 235 | 319 |
| Interest expense | (279,499) | (448,771) |
| Other income | 27,076 | 46,281 |
| Other expenses | (24,538) | (43,196) |
| Total non-operating expenses, net | (276,726) | (445,367) |
| Income (loss) before income tax | 450,956 | (909,841) |
| Income tax expense | - | - |
| Net income (loss) | 450,956 | (909,841) |
| Foreign currency translation gain (loss) | (217,769) | 93,407 |
| Comprehensive income (loss) | \$233,187 | \$(816,434) |
| Basic and diluted weighted average shares outstanding | 24,982,822 | 24,982,822 |
| Basic and diluted earnings (loss) per share | \$0.02 | \$(0.04) |

The accompanying notes are an integral part of these financial statements.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(UNAUDITED)

| | Three months ended March, 31 | |
|------------------------------------------------------------------------------------------|------------------------------|------------------|
| | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ 450,956 | \$ (909,841) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 177,826 | 159,466 |
| Amortization of interest | 15,223 | 14,834 |
| Decrease in bad debt allowance | (709,595) | - |
| Provision for inventory impairment | 201,922 | 94,570 |
| (Increase) decrease in assets: | | |
| Restricted cash | 243,585 | - |
| Accounts receivable | 1,060,374 | 386,062 |
| Retentions receivable | 512,030 | 49,677 |
| Notes receivable | 719,843 | 635,502 |
| Other receivables, deposits and prepayments | (434,397) | 1,100 |
| Advances to suppliers | 279,907 | (523,654) |
| Inventories | (664,768) | (569,660) |
| Increase (decrease) in liabilities: | | |
| Accounts payable | (341,887) | (274,503) |
| Accrued expenses | 166,556 | 255,028 |
| Advance from customers | 58,532 | 762,362 |
| Taxes payable | (4,413) | (60,097) |
| Net cash provided by operating activities | 1,731,694 | 20,846 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Acquisition of property & equipment | (2,216) | (10,074) |
| Net cash used in investing activities | (2,216) | (10,074) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Due from shareholder | - | (41,946) |
| Advances from shareholder | 926,546 | - |
| Repayment of short term loans | (2,255,639) | - |
| Net cash used in financing activities | (1,329,093) | (41,946) |
| EFFECT OF EXCHANGE RATE CHANGE ON CASH & EQUIVALENTS | 5,534 | 141 |
| NET INCREASE (DECREASE) IN CASH & EQUIVALENTS | 405,919 | (31,033) |

| | | |
|-----------------------------------------|------------|-----------|
| CASH & EQUIVALENTS, BEGINNING OF PERIOD | 8,178 | 42,996 |
| CASH & EQUIVALENTS, END OF PERIOD | \$ 414,097 | \$ 11,963 |
| Supplemental Cash flow data: | | |
| Income tax paid | \$ - | \$ - |
| Interest paid | \$ 71,082 | \$ 62,722 |

The accompanying notes are an integral part of these financial statements.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 (UNAUDITED) AND DECEMBER 31, 2013

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

CleanTech Innovations, Inc., formerly known as Everton Capital Corporation (the “Company” or “CleanTech”), was incorporated on May 9, 2006, in the State of Nevada. Through its wholly owned operating subsidiaries in China, the Company designs, manufactures tests and sells structural towers for on-land and off-shore wind turbines. The Company also manufactures specialty metal products that require advanced manufacturing and engineering capabilities, including bellows expansion joints and connecting bend pipes used for waste heat recycling in steel production, in ultra-high-voltage electricity transmission grids and in industrial pressure vessels.

Liaoning Creative Bellows Co., Ltd. (“Creative Bellows”) was incorporated in the PRC province of Liaoning on September 17, 2007. Creative Bellows designs and manufactures bellows expansion joints, pressure vessels, wind tower components for wind turbines and other fabricated metal specialty products. On May 26, 2009, the three individual shareholders of Creative Bellows established Liaoning Creative Wind Power Equipment Co., Ltd. (“Creative Wind Power”). During 2009, the three shareholders transferred their Creative Wind Power shares to Creative Bellows at cost; as a result of the transfer of ownership, Creative Bellows owned 100% of Creative Wind Power. Creative Wind Power markets and sells wind tower components designed and manufactured by Creative Bellows.

The consolidated interim financial information as of March 31, 2014 and for the three month periods ended March 31, 2014 and 2013 was prepared without audit, pursuant to the rules and regulations of the Security and Exchange Commission (“SEC”). Certain information and footnote disclosures, which are normally included in consolidated financial statements prepared in accordance with United States Generally Accepted Accounting Principles (“U.S. GAAP”) were not included. The interim consolidated financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013, that were filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company’s consolidated financial position as of March 31, 2014, its consolidated results of operations and cash flows for the three month periods ended March 31, 2014 and 2013, as applicable, were made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements were prepared in conformity with U.S. GAAP. The Company’s functional currency is the Chinese Yuan Renminbi (“RMB”); however, the accompanying consolidated financial statements were translated and presented in United States Dollars (“USD”). The accompanying consolidated financial statements present the historical financial condition, results of operations and cash flows of the operating companies.

Going Concern

The Company had accumulated deficit of \$16.18 million as of March 31, 2014 although the Company incurred net income of \$0.45 million for the three months ended March 31, 2014. In addition, the Company had promissory notes of \$10 million and \$50,000 that are past due. Through a new Line of Credit Agreement entered with the same lender

on August 17, 2013, the default promissory note of \$10 million became payable upon Note-holder's request (See Note 11). As of March 31, 2014, the Company had an outstanding balance of \$0.65 million including accrued interest under this credit line and \$453,992 under short term payable currently in default. The Company has been unable to raise funds from the U.S. markets to pay off these obligations. During the quarter ended March 31, 2014, the Company's shareholder who is also the CEO of the Company lent \$929,679 for Company's operating needs (See Note 17). These conditions raise a substantial doubt as to whether the Company may continue as a going concern. The Company is seeking to obtain additional financing from local banks in the PRC. The Company will also seek to improve its cash flows from operations by implementing cost control measures and reducing inventory purchases.

Principles of Consolidation

The consolidated financial statements include the accounts of CleanTech and its wholly owned subsidiaries, Creative Bellows and Creative Wind Power. All intercompany transactions and account balances were eliminated in consolidation.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 (UNAUDITED) AND DECEMBER 31, 2013

Use of Estimates

In preparing financial statements in conformity with U.S. GAAP, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates include the recoverability of long-lived assets and the valuation of inventories. Actual results could differ from those estimates.

Cash and Equivalents

Cash and equivalents include cash on hand, demand deposits placed with banks or other financial institutions and all highly liquid investments with an original maturity of three months or less as of this purchase date

Restricted Cash

Restricted cash consists of a percentage of sales deposited by the Company into its bank accounts according to contract terms, which serves as a contract execution and product delivery guarantee. The restriction is released upon customer acceptance of the product.

Accounts and Retentions Receivable

The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Past due receivables are determined based on contractual payment terms specified in the contract. Based on its historical collection activity, the Company had allowances for bad debts of \$3,776,839 and \$4,523,084 at March 31, 2014 and December 31, 2013, respectively.

At March 31, 2014 and December 31, 2013, the Company had gross retentions receivable for product quality assurance of \$2,212,251 and \$2,746,082, respectively. The retention generally is 10% of the sales price with a one-year term, but no later than the termination of the warranty period. The Company had allowances for retentions receivable of \$1,679,648 and \$1,694,855 at March 31, 2014 and December 31, 2013, respectively.

Inventories

The Company's inventories are valued at the lower of cost or market, with cost determined on a weighted average basis. The Company compares the cost of inventories with market value and an allowance is made to write down the inventories to their market value, if lower.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are expensed as incurred; additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method for substantially all assets with 5% salvage value and estimated lives as follows:

| | | |
|-------------------|--------|-------|
| Buildings | 40 | Years |
| Machinery | 5 - 15 | Years |
| Vehicles | 5 | Years |
| Office equipment | 5 | Years |
| Testing equipment | 10 | Years |

Land Use Rights

Right to use land is stated at cost less accumulated amortization. Amortization is provided using the straight-line method over 50 years.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 (UNAUDITED) AND DECEMBER 31, 2013

Revenue Recognition

The Company's revenue recognition policies are in compliance with SEC Staff Accounting Bulletin ("SAB") 104 (codified in FASB ASC Topic 605). Sales revenue, including the final 10% of the purchase price, is recognized after delivery is complete, customer acceptance of the product occurs and collectability is reasonably assured. Customer acceptance occurs after the customer puts the product through a quality inspection, which normally is completed within one to two weeks from customer receipt of the product. In case of sales contracts with FOB shipping terms, the customer is responsible for cost of freight and insurance and revenue is recognized when products are delivered to the carrier. In case of sales contracts with FOB destination terms, the Company is responsible for the cost of freight and insurance and revenue is recognized when customer acceptance is received. The customer is responsible for installation and integration of our component products into its end products. Payments received before satisfaction of all relevant criteria for revenue recognition are recorded as unearned revenue or advances from customers. Unearned revenue or advances from customers consists of payments received from customers prior to customer acceptance of the product.

The Company's standard payment terms with its wind tower customers generally provide that 10% of the purchase price is due upon the Company's deposit of restricted cash into a bank account as a contract guarantee, 20% upon the Company's purchase of raw material for the order, 10% upon delivery of the base ring component of the wind towers, 30% upon delivery of the wind tower tube sections and 20% upon customer inspection and acceptance of the product, which customers normally complete within 1-2 weeks after delivery. As a common practice in the manufacturing business in PRC, payment of the final 10% of the purchase price is due no later than the termination date of the product warranty, which can be up to 12 months from the customer acceptance date. The final 10% of the purchase price (retentions receivable) is recognized as revenue upon customer acceptance of the product. For the Company's bellows expansion joints and pressure vessels, payment terms are negotiated on a case-by-case basis and these payment percentages and terms may differ for each customer.

Sales revenue is the invoiced value of goods, net of value-added tax ("VAT"). The Company's products sold and services provided in China are subject to VAT of 17% of the sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing the finished product. The Company recorded VAT payable and VAT receivable net of payments in the financial statements. The VAT tax return is filed offsetting the payables against the receivables.

Warranties

The Company offers a product warranty to its customers of up to 12 months depending on the terms negotiated with each customer. During the warranty period, the Company will repair or replace defective products free of charge. The Company commenced production in 2009 and as of March 31, 2014, the Company accrued \$8,134 in warranty expense. The Company implemented internal manufacturing protocols designed to ensure product quality beginning from the receipt of raw materials to the final inspection at the time products are shipped. The Company monitors warranty claims and accrues for warranty expense accordingly, using ASC Topic 450 to account for its standard warranty.

The Company provides warranty to all customers and does not consider it an additional service; rather, the warranty is considered an integral part of the product's sale. There is no general right of return indicated in the contracts or purchase orders. If a product under warranty is defective or malfunctions, the Company is responsible for fixing it or

replacing it with a new product. The Company's products are its only deliverables.

The Company's warranty reserve activity for the three months ended March 31, 2014 and year ended December 31, 2013 is as follows:

| | 2014 | | 2013 | |
|-----------------------------------|------|-------|------|---------|
| Balance at beginning of period | \$ | 8,188 | \$ | 9,790 |
| Foreign currency translation loss | | (54) | | (1,602) |
| Actual costs incurred | | | | - |
| Ending balance (accrued expense) | \$ | 8,134 | \$ | 8,188 |

After the warranty period, the Company charges for after-sales services on its products. Such revenue is recognized when the service is provided. For the three months ended March 31, 2014 and years ended December 31, 2013, the Company had no after-sales services income. The warranty reserve is included in accrued expense (Note 10).

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 (UNAUDITED) AND DECEMBER 31, 2013

Cost of Goods Sold

Cost of goods sold (“COGS”) consists primarily of material, labor and related overhead, which are attributable to the products, and other indirect costs that benefit all products. Write-down of inventory to lower of cost or market is also recorded in COGS.

Research and Development

Research and development (“R&D”) costs are related primarily to the Company’s development and testing of its new technologies used to manufacture its bellows-related products. R&D costs are expensed as incurred. For the three months ended March 31, 2014 and 2013, R&D was \$31,377 and \$46,513, respectively, and was included in general and administrative expenses.

Shipping and Handling Costs

Shipping and handling costs for delivery of finished goods are included in selling expenses. During the three months ended March 31, 2014 and 2013, shipping and handling costs were \$17,678 and \$25,922, respectively.

Basic and Diluted Earnings per Share (“EPS”)

Basic EPS is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed similar to basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if all the potential common shares, warrants and stock options had been issued and if the additional common shares were dilutive. Diluted EPS are based on the assumption that all dilutive convertible shares and stock options and warrants were converted or exercised. Dilution is computed by applying the treasury stock method for the outstanding options and warrants, and the if-converted method for the outstanding convertible preferred shares. Under the treasury stock method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Under the if-converted method, convertible outstanding instruments are assumed to be converted into common stock at the beginning of the period (or at the time of issuance, if later).

The warrants and options to purchase up to 1,987,500 and 2,821,310 shares of common stock were anti-dilutive during the three months ended March 31, 2014 and 2013, respectively.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist primarily of accounts and other receivables and advances to suppliers. The Company does not require collateral or other security to support these receivables. The Company conducts periodic reviews of its clients’ financial condition and customer payment practices to minimize collection risk on accounts receivable.

Cash includes cash on hand and demand deposits in bank accounts maintained within China. Cash balances at financial institutions within China are not covered by insurance. The Company has not experienced any losses in such accounts.

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

Statement of Cash Flows

In accordance with SFAS No. 95, "Statement of Cash Flows," codified in FASB ASC Topic 230, cash flows from the Company's operations are calculated based upon local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows may not necessarily agree with changes in the corresponding balances on the balance sheet.

Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with SFAS No. 123R, "Share-Based Payment, an Amendment of FASB Statement No. 123" (codified in FASB ASC Topics 718 and 505). The Company recognizes in the income statement the grant-date fair value ("FV") of stock options and other equity-based compensation issued to employees and non-employees.

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CLEANTECH INNOVATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 (UNAUDITED) AND DECEMBER 31, 2013

Foreign Currency Translation and Transactions

The accompanying consolidated financial statements are presented in USD. The Company's functional currency is RMB, which is translated into USD for balance sheet accounts using the current exchange rates in effect as of the balance sheet date and for revenue and expense accounts using the average exchange rate during the period. The translation adjustments are recorded as a separate component of stockholders' equity, captioned accumulated other comprehensive income (loss). Gains and losses resulting from transactions denominated in foreign currencies are included in other income (expense) in the consolidated statements of operations.

The RMB to USD exchange rates in effect as of March 31, 2014 and December 31, 2013, were \$1 = RMB 6.1521 and \$1 = RMB 6.0969, respectively. The average RMB to USD exchange rates in effect for the three months ended March 31, 2014 and 2013, were \$1 = RMB 6.1180 and \$1 = RMB 6.2785, respectively. The exchange rates used in translation from RMB to USD were published by the People's Bank of China.

Comprehensive Income (Loss)

The Company uses SFAS No. 130 "Reporting Comprehensive Income" (codified in FASB ASC Topic 220). Comprehensive income is comprised of net income and all changes to the statements of stockholders' equity, except those due to investments by stockholders, changes in paid-in capital and distributions to stockholders. Comprehensive income (loss) for the three months ended March 31, 2014 and 2013 included net income (loss) and foreign currency translation adjustments.

Segment Reporting

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (codified in FASB ASC Topic 280), requires use of the "management approach" model for segment reporting. The management approach model is based on the way a company's management organizes segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure or any other manner in which management disaggregates a company.

Management determined the Company's product lines – wind towers, bellows expansion joints and pressure vessels – constitute a single reportable segment under ASC 280. The Company operates exclusively in one business: the design and manufacture of highly engineered metal components for heavy industry. The manufacturing processes for each of the Company's products, principally the rolling and welding of raw steel materials, make uses of the same pool of production workers and engineering talent for design, fabrication, assembly and testing. The Company's products are characterized and marketed by their ability to withstand temperature, pressure, structural load and other environmental factors. The Company's products are used by major electrical utilities and large-scale industrial companies in China specializing in heavy industry, and the Company's sales force sells its products directly to these companies, which utilize the Company's components in their finished products. All of the Company's long-lived assets for production are located in its facilities in Tieling, Liaoning Province, China, and operate within the same environmental, safety and quality regulations governing industrial component manufacturing companies. The Company established its subsidiary, Creative Wind Power, solely to market and sell the Company's wind towers, which constitute the structural support cylinder for an industrial wind turbine installation. Management believes that the economic characteristics of the Company's product lines, specifically costs and gross margin, will be similar as production increases and labor continues to be shared across products.

As a result, management views the Company's business and operations for all product lines as a blended gross margin when determining future growth, return on investment and cash flows. Accordingly, management concluded the Company had one reportable segment under ASC 280 because: (i) all of the Company's products are created with similar production processes, in the same facilities, under the same regulatory environment and sold to similar customers using similar distribution systems; and (ii) gross margins of all product lines have been converging and should continue to converge.

Following is a summary of sales by products for the three months ended March 31, 2014 and 2013:

| | 2014 | 2013 |
|---------------------------------------|--------------|------------|
| Bellows expansion joints and related | \$ 260,202 | \$ 130,301 |
| Pressure vessels (heat exchanger) | 239,963 | - |
| Other – high temperature compensators | 61,050 | 122,518 |
| Forging products | 1,366,378 | - |
| Total | \$ 1,927,593 | \$ 252,819 |

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New Accounting Pronouncements

In January 2014, FASB issued, Accounting Standards Update 2014-01, Investments—Equity Method and Joint Ventures (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects. The objective of this Update is to provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The adoption of this ASU will not affect the Company's financial statements.

In January 2014, FASB issued, Accounting Standards Update 2014-05, Service Concession Arrangements (Topic 853), The objective of this Update is to specify that an operating entity should not account for a service concession arrangement within the scope of this Update as a lease in accordance with Topic 840, Leases. Service concession arrangements may become more prevalent in the United States as public-sector entities seek alternative ways to provide public services on a more efficient and cost-effective basis. The amendments apply to an operating entity of a service concession arrangement entered into with a public-sector entity grantor when the arrangement meets certain conditions. The amendments in this Update should be applied on a modified retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. The modified retrospective approach requires the cumulative effect of applying this Update to arrangements existing at the beginning of the period of adoption to be recognized as an adjustment to the opening retained earnings balance for the annual period of adoption. The amendments are effective for a public business entity for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of this ASU will not affect the Company's financial statements.

3. OTHER RECEIVABLES (NET) AND DEPOSITS

Other receivables and deposits consisted of the following at March 31, 2014 and December 31, 2013:

| | 2014 | 2013 |
|--------------------------------------|--------------|--------------|
| Deposits for contract bids | \$ 101,807 | \$ 97,603 |
| Advance to employees | 203,348 | 87,943 |
| Advance to unrelated party companies | 1,626,549 | 295,232 |
| Deposit for land use right bid | - | 328,036 |
| Other | 1,145,239 | 2,462,948 |
| Less: bad debt allowance | (508,902) | (513,509) |
| Total, net | \$ 2,568,041 | \$ 2,758,253 |

As of March 31, 2014, other of \$1,145,239 mainly consisted of retainers for legal expense of \$270,000, and the receivables of \$785,992 from suppliers, which the Company previously prepaid for raw material purchases in the aggregate of \$3,279,060 but the purchase orders were later cancelled by the Company. The Company collected \$2.49

million as of March 31, 2014 and expected to collect the full payments in 2014. Advance to unrelated party companies of \$1,626,549 was various short-term loans, bore no interest, and payable upon demand. As of December 31, 2013, other of \$2,462,948 mainly consisted of receivable of \$607,040 from sales of equipment, retainers for legal expense of \$270,000, and the receivables of \$993,808 from suppliers, which the Company previously prepaid in the first quarter of 2013 for raw material purchases but the purchase orders were later cancelled by the Company. Advance to unrelated party companies of \$295,232 was various short-term loans, bore no interest, and payable upon demand. Deposit of \$328,036 was an initial deposit for company to bid for a land use right; however, this deposit was refunded to the Company during the three months ended March 31, 2014 due to the Company failed the bidding for the purchase.

4. ADVANCES TO SUPPLIERS

Advances to suppliers mainly consisted of prepayments to suppliers for raw materials which were mainly comprised of steel.

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5. INVENTORIES

Inventories consisted of the following at March 31, 2014 and December 31, 2013:

| | 2014 | 2013 |
|------------------------------------------|--------------|--------------|
| Raw materials | \$ 3,750,268 | \$ 2,988,859 |
| Finished goods | 1,442,516 | 1,649,209 |
| Work in process | 5,067,336 | 5,047,877 |
| Less: allowance for inventory impairment | (3,792,257) | (3,623,971) |
| Total, net | \$ 6,467,863 | \$ 6,061,974 |

6. NOTES RECEIVABLE – BANK ACCEPTANCES

The Company sold goods to its customers and received commercial notes (bank acceptances) from them in lieu of payment for accounts receivable. The Company discounted these notes with a bank or endorsed notes to vendors for payment of its obligations or to get cash from third parties. Most of the commercial notes have a maturity of less than six months. These notes receivable are with recourse and the Company is contingently liable to make the payment to the endorsee in case of a default. As of March 31, 2014 and December 31, 2013, the Company had notes receivable of \$0.26 million and \$0.59 million, respectively that were endorsed to vendors as payments for the Company's obligation (contingent liability).

7. PREPAYMENTS

Long-term prepayments mainly were a prepaid land occupancy fee paid to the inhabitants of the land on which the Company plans to construct a manufacturing plant. Currently, the Company amortizes prepaid rental over 50 years according to the terms of the lease agreement.

8. PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following at March 31, 2014 and December 31, 2013:

| | 2014 | 2013 |
|--------------------------|---------------|---------------|
| Buildings | \$ 10,561,889 | \$ 10,657,514 |
| Equipment and machinery | 2,748,018 | 2,770,675 |
| Vehicle | 36,898 | 37,232 |
| Office equipment | 108,946 | 109,933 |
| Total | 13,455,751 | 13,575,354 |
| Accumulated depreciation | (1,859,993) | (1,721,779) |
| Total, net | \$ 11,595,758 | \$ 11,853,575 |

Depreciation for the three months ended March 31, 2014 and 2013 was \$154,519 and \$144,174, respectively.

9. INTANGIBLE ASSETS

Intangible assets consisted of land use right and patents. All land in the PRC is government-owned and cannot be sold to any individual or company. However, the government grants the user a “land use right” to use the land. The Company has the right to use the land for 50 years and amortizes the right on a straight-line basis over 50 years.

The Company was granted an exclusive license to use a production method patent until December 31, 2016, for lead-free soft solder with mischmetal from the Shenyang Industry University. The Company paid a one-time use of technology fee of RMB 100,000 (\$15,887).

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Intangible assets as of March 31, 2014 and December 31, 2013 were as follows:

| | 2014 | 2013 |
|--------------------------|--------------|--------------|
| Land use right | \$ 4,567,757 | \$ 4,634,762 |
| Patents | 16,255 | 16,401 |
| Total | 4,584,012 | 4,651,163 |
| Accumulated amortization | (482,476) | (489,105) |
| Total, net | \$ 4,101,536 | \$ 4,162,058 |

Amortization of intangible assets for the three months ended March 31, 2014 and 2013 was \$23,307 and \$15,292, respectively. At March 31, 2014, annual amortization for the next five years was expected to be as follows:

| Year | Amount |
|------------|--------------|
| 2015 | \$ 93,286 |
| 2016 | 93,286 |
| 2017 | 93,286 |
| 2018 | 93,286 |
| 2019 | 93,286 |
| Thereafter | 3,635,106 |
| Total | \$ 4,101,536 |

As of March 31, 2014 and December 31, 2013, the Company is in the process of acquiring a land use right in the Liaoning Province Tieling Economic and Technological Development Zone for which a land use right deposit of \$0.4 million was made to Tieling Yinzhou Industrial Park Management Committee and Tieling Economic Development Zone Non-Tax Revenue Bureau. The deposit of the land use right was transferred into intangible assets during the first quarter of 2012; however, the Company has not obtained the land use right as of this report date.

10. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables at March 31, 2014 and December 31, 2013 were as follows:

| | 2014 | 2013 |
|-----------------------|--------------|--------------|
| Payroll-related | \$ 97,779 | \$ 111,800 |
| Warranty (note 2) | 8,134 | 8,188 |
| Other | 87,043 | 95,210 |
| Accrued interest | 3,924,119 | 3,737,396 |
| Accrued legal expense | 400,808 | 400,808 |
| Total | \$ 4,517,883 | \$ 4,353,402 |

As of March 31, 2014 and December 31, 2013, the Company had \$400,808 accrued legal expense and \$75,209 and \$66,315 accrued interest, respectively, for unpaid legal fees to a law firm in connection with the representation of the Company in its lawsuit against the NASDAQ Stock Market, LLC and NASDAQ OMX Group.

Accrued interest included interest on promissory notes, line of credit and credit union loans and interest on amount owed to legal expenses (See Note 11). The Company paid in full credit union loans along with interest during the

three months ended March 31, 2014.

11. SHORT-TERM LOANS

On September 13, 2010, the Company borrowed \$1,827,050, \$953,243 and \$556,059 from three different credit unions. Each loan bore interest of 7.2% and was to mature on September 12, 2011. The Company extended the maturity date of the loans through an agreement with one of the credit unions. Pursuant to this agreement, the Company was required to pay \$317,415 (RMB 2,000,000) by October 2011, with the remaining balance to be paid by June 2012. However, the Company did not make the payment of \$317,415 (RMB 2,000,000), as per the agreement and, as such, the extension of maturity date was not granted. As of March 31, 2014, the Company repaid all three loans.

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On December 13, 2010, the Company entered into a loan with a lender for \$10 million. At the Lender's option, the principal amount of the note and all interest thereon shall be paid in either USD or RMB at an exchange rate of RMB 6.90 to USD 1.00 if paid on or before March 1, 2012, and thereafter at an exchange rate of RMB 6.30 to USD 1.00 to the Lender or any designee of Lender as provided to the Company in writing by Lender. The loan bore interest of 10% payable in advance at the beginning of each quarter with a maturity of March 1, 2012. The loan was amended to mature on March 1, 2013, and to decrease the interest rate to 8.5%, effective March 1, 2012, which interest shall be payable quarterly in advance. From March 1, 2012 through August 13, 2013, the Company was in default on interest payment that was required to pay in advance; the Company was also in default in payment of \$10 million loan due on March 1, 2013. Therefore the interest, from the date of the Default, was at the lesser of 24% or the maximum applicable legal rate. The Company used 24% as default interest rate from March 1, 2012 through August 13, 2013. After August 13, 2013, the interest rate on the \$10 million loan was 8.5% according to the Line of Credit Agreement described below. The Company had interest payable of \$3.84 million as of March 31, 2014.

Through a new Line of Credit Agreement entered with the same lender on August 17, 2013, this default loan became payable upon Note-holder's request and the interest rate at 8.5% after August 13, 2013. The Promissory Note entered on August 17, 2013 along with an Escrow Agreement was for a Line of Credit available to the Company of up to \$10 million. The lender deposits the required amount into an escrow account each time before disbursement, and the escrow agent disburses some or all of the deposit from time to time as directed in writing by the lender for advancing the Company to pay expenses that are approved by the lender. The applicable interest rate for the amount borrowed under this line of credit is 3% during the first six months following each advance, and 0% thereafter, to be paid on the first day of each month, with maturity upon Note-holder's request. The promissory note has a default rate of 24%. As of March 31, 2014, the Company borrowed \$0.65 million from the credit line and accrued interest of \$8,939.

On December 14, 2011, the Company entered into a 3% promissory note with a lender for \$50,000, maturing on February 1, 2012, for the payment of its legal expenses. As of March 31, 2014, the Company had accrued interest of \$6,690 on this note. The note is past due with default interest at 6% accrued subsequent to February 1, 2012.

At March 31, 2014 and December 31, 2013, the short-term loans consisted of the following:

| | 2014 | 2013 |
|---------------------------------------|---------------|---------------|
| Promissory Note of US parent | 50,000 | 50,000 |
| Loan of U.S. Parent | 10,000,000 | 10,000,000 |
| Credit line payable of U.S. Parent | 638,951 | 638,951 |
| Credit union loan, Chinese subsidiary | - | 2,263,445 |
| Total short term loan | \$ 10,688,951 | \$ 12,952,396 |

12. TAXES PAYABLE (RECEIVABLE)

Taxes payable (receivable) consisted of the following at March 31, 2014 and December 31, 2013:

| | 2014 | 2013 |
|-----------------|------------|-----------|
| Value-added tax | \$ (5,670) | \$ 23,543 |
| Income tax | (8,144) | (8,218) |
| Other | 77,047 | 52,909 |
| Total | \$ 63,233 | \$ 68,234 |

13. SHORT-TERM PAYABLE

On September 21, 2009, the Company entered into a construction contract with a local authority, the Administration Committee for Liaoning Special Vehicle Production Base (“LSVPB”), to build a plant. LSVPB was responsible for the construction of the main body of the plant and the Company was responsible for the construction of certain infrastructure for the plant, including plumbing, heating and electrical systems. The plant is 9,074 square meters with construction costs of RMB 1,350 (\$214) per square meter.

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LSVPB was responsible for hiring a qualified construction team according to the Company's approved design and the Company needed to approve any material changes to the design during construction. LSVPB was also responsible for site survey, quality supervision and completion of inspection, as well as the transfer of all construction completion records to the Company. Upon completion of the Company's ownership registration, the Company was required to pledge the plant as collateral for payment by the Company to LSVPB of \$1,944,151 (RMB 12,249,900). The pledge will terminate upon payment in full by the Company.

The Company is to pay LSVPB for the cost of the project in five equal annual installments in October of each year beginning in October 2010. The Company is not required to pay interest, and ownership of the plant will transfer to the Company upon payment in full. The default penalty is 0.5% of the amount outstanding, compounded daily, in the event of a default. LSVPB has the right to foreclose on the plant if payments are in arrears for more than two years, in which case all prior payments made by the Company will be treated as liquidated damages by LSVPB.

The Company recorded the cost of construction at the present value of the five annual payments by imputing interest of 9% from when the Company started using the plant. Depreciation of the construction cost and amortization of the unamortized interest commenced on the date of occupation and use. The Company started using the plant on August 30, 2010. The certificate of the property ownership was received in the third quarter of 2011.

In the fourth quarter of 2011, the Company received a subsidy from LSVPB of \$1.11 million (RMB 7,000,000) against the outstanding payment. In the first quarter of 2012, the Company repaid \$382,886 (RMB 2,410,000). During the three months ended March 31, 2014 and 2013, the Company did not make any payments and is currently in default as of March 31, 2014. The Company expects to pay the remaining amount by the due date of October 2014.

At March 31, 2014, the short-term payable consisted of the following:

| | |
|----------------------------|------------|
| Short-term payable | \$ 461,615 |
| Less: unamortized interest | (7,623) |
| Net | 453,992 |

14. MAJOR CUSTOMERS AND VENDORS

One customer accounted for 83% of sales for the three months ended March 31, 2014. At March 31, 2014, total receivable from this customer was \$566,395.

Three customers accounted for 93% of sales for the three months ended March 31, 2013, and each customer accounted for 36%, 31% and 26% of total sales, respectively. At March 31, 2013, total receivables from these customers were \$299,298.

One vendor accounted for 62% of total purchases for the three months ended March 31, 2014. At March 31, 2014, the total payable to this vendor was \$0.

Two vendors accounted for 32% of total purchases for the three months ended March 31, 2013, and each vendor accounted for 15% and 17% of total purchases, respectively. At March 31, 2013, the total payable to these vendors were \$0.

15. DEFERRED TAX ASSET (LIABILITY)

Deferred tax asset (liability) represented differences between the bad debt allowance and provision of inventory impairment booked by the Company which was not allowed per tax purpose, and net operating loss for income tax purpose. As of March 31, 2014 and December 31, 2013, deferred tax asset (liability) consisted of the following:

| | 2014 | 2013 |
|------------------------------------------------------------------|--------------|--------------|
| Deferred tax asset - current (bad debt allowance) | \$ 1,364,122 | \$ 1,554,485 |
| Deferred tax asset - current (inventory allowance) | 948,064 | 905,993 |
| Deferred tax asset – current (allowance to other receivable) | 127,225 | 128,377 |
| Deferred tax asset – current (allowance for advance to supplier) | 1,441,427 | 1,454,477 |
| Deferred tax asset – noncurrent (NOL) | 2,712,218 | 2,646,258 |
| Less: valuation allowance | (6,593,056) | (6,689,590) |
| Net | \$ - | \$ - |

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16. INCOME TAX

The Company is subject to income taxes by entity on income arising in or derived from the tax jurisdiction in which each entity is domiciled.

CleanTech, the U.S. parent company, was incorporated in the U.S. and has net operating losses (NOL) for income tax purposes. CleanTech has NOL of \$7.98 million as of March 31, 2014, which may be available to reduce future years' taxable income as NOL can be carried forward up to 20 years from the year the loss is incurred. Management believes the realization of benefits from these losses remains uncertain due to CleanTech's, the U.S. parent company, has limited operating history and continuing losses. Accordingly, a 100% deferred tax asset valuation allowance was provided.

Creative Bellows and Creative Wind Power generated substantially all of their net income from their PRC operations and are governed by the Income Tax Law of the PRC for privately-run enterprises. According to this law, privately-run enterprises are generally subject to a tax rate of 25% on income reported in the privately-run enterprises' financial statements, after appropriate tax adjustments.

According to the new income tax law that became effective January 1, 2008, new high-tech enterprises given special support by the PRC government are subject to an income tax rate of 15%. Creative Bellows was recognized as a new high-tech enterprise and registered its status with the tax bureau, providing it with an income tax rate of 15% from 2010 through 2012, and 25% for 2013 and the years after.

The following table reconciles the U.S. statutory rates to the Company's consolidated effective tax rate for the three months ended March 31, 2014 and 2013:

| | 2014 | 2013 |
|--------------------------------|----------|--------|
| U.S. statutory rates (benefit) | 34.0% | (34)% |
| Tax rate difference | (12.9) % | 6.8 % |
| Utilization of NOL | (38.6) % | - % |
| Valuation allowance | 17.5 % | 27.2 % |
| Effective income tax rate | - % | - % |

17. ADVANCES FROM SHAREHOLDER

As of March 31, 2014, the Company had \$929,679 advance from the Company's shareholder (also Company's CEO) for the Company's operating needs, this advance did not have any interest, and payable upon demand.

18. STOCKHOLDERS' EQUITY

Common Stock with Warrants Issued for Cash

On December 13, 2010, the Company completed a closing of \$20,000,000 in a combination of debt and equity offerings through accredited institutional investors. In a private placement of equity, the Company sold 2,500,000 units, consisting of one share of its common stock and a warrant to purchase 67.5% of one share of its common stock, at \$4.00 per unit for \$10,000,000. The warrants are immediately exercisable, expire on the fifth anniversary of their

issuance and entitle the holders to purchase up to 1,687,500 shares of the Company's common stock at \$4.00 per share. For its assistance in the private placement of equity, the Company paid a placement agent \$1,000,000 and issued it warrants to purchase 300,000 shares of the Company's common stock under the same terms as the warrants issued in the private placement. The Company also paid the placement agent \$100,000 for its assistance in arranging the loan. The FV of the warrants was calculated using the Black-Scholes model and the following assumptions: estimated life of five years, volatility of 88%, risk-free interest rate of 1.89% and dividend yield of 0%. No estimate of forfeitures was made as the Company has a short history of granting options and warrants. The FV of the warrants at grant date was \$10,282,442.

Concurrently with the closing of the private placement on December 13, 2010, the Company entered into a long-term loan agreement with a lender for \$10 million (See Note 11).

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Following is a summary of the warrant activity:

| | Number of Shares | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term in Years |
|-----------------------------------|---------------------|-------------------------------------------------------|------------------------------------------------------------------|
| Outstanding at January 1, 2014 | 1,987,500 | \$ 4.00 | 1.95 |
| Exercisable at January 1, 2014 | 1,987,500 | \$ 4.00 | 1.95 |
| Granted | - | - | - |
| Exercised | - | - | - |
| Expired | - | - | - |
| Outstanding at March 31, 2014 | 1,987,500 | \$ 4.00 | 1.70 |
| Exercisable at March 31, 2014 | 1,987,500 | \$ 4.00 | 1.70 |

19. STATUTORY RESERVES

Pursuant to the corporate law of the PRC effective January 1, 2006, PRC subsidiaries of the Company's operating subsidiaries in China are required to maintain one statutory reserve by appropriating from its after-tax profit before declaration or payment of dividends. The statutory reserve represents restricted retained earnings.

Surplus reserve fund

The Company's Chinese subsidiaries are required to transfer 10% of their net income, as determined under PRC accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the Company's registered capital. The Company's Chinese subsidiaries are not required to make appropriation to other reserve funds and have no intentions to make appropriations to any other reserve funds. There are no legal requirements in the PRC to fund these reserves by transfer of cash to restricted accounts, and the Company's Chinese subsidiaries do not do so.

The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

Common welfare fund

Common welfare fund is a voluntary fund into which the Company can elect to transfer 5% to 10% of its net income. The Company did not make any contribution to this fund for the three months ended March 31, 2014 and 2013.

This fund can only be utilized on capital items for the collective benefit of the Company's employees, such as construction of dormitories, cafeteria facilities and other staff welfare facilities. This fund is non-distributable other than upon liquidation.

20. OPERATING RISKS

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

The Company's sales, purchases and expenses transactions are denominated in RMB and all of the Company's assets and liabilities are also denominated in RMB. The RMB is not freely convertible into foreign currencies under current PRC law. In China, foreign exchange transactions are required by law to be transacted only by authorized financial institutions. Remittances in currencies other than RMB may require certain supporting documentation to affect the remittance.

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21. LITIGATION

As of March 31, 2012, Creative Bellows had a case pending in arbitration for the recovery of approximately one million RMB. Creative Bellows filed the arbitration proceeding for a breach of contract by Dongbei Jincheng Construction Co., Ltd., a plant construction contractor. On March 14, 2013, Dongbei JinCheng filed a complaint in the Tieling Intermediate People's Court against the Company, alleging that the Company owes it construction costs in the amount of RMB 2,400,099.82 plus RMB 700,000 interest and RMB 28,176 arbitration expenses. On March 19, 2013, the company filed a counterclaim against Dongbei JinCheng, alleging that Dongbei JinCheng breached the contract by failing to complete the construction work according to quality specifications. The Company sought in RMB 2,197,131.53 monetary damages. On October 9, 2013, Dongbei JinCheng was ordered by the court to pay RMB 27,000 examination fee, RMB 77,413.89 repair costs and RMB 13,000 design and appraisal costs to the Company. On October 10, 2013, the Company filed an appeal against Dongbei JinCheng to Liaoning High People's Court in order to obtain higher damages. As of this report date, this case is under review by Liaoning High People's Court.

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Critical Accounting Policies

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

Basis of Presentation

Our financial statements are prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP.

Principles of Consolidation

The consolidated financial statements include the accounts of CleanTech, Creative Bellows and Creative Wind Power. All intercompany transactions and account balances are eliminated in consolidation.

Use of Estimates

In preparing financial statements in conformity with U.S. GAAP, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates, required by management, include the recoverability of long-lived assets and the valuation of inventories. Actual results could differ from those estimates.

Accounts and Retentions Receivable

We maintain reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Past due receivables are determined based on payment terms specified in the contract. We do not anticipate any significant credit risk because the majority of our customers are large, well-capitalized state-owned and publicly traded utility and industrial companies with stable operations. The retention is 10% of the sales price with a term of one year, but no later than the termination of the warranty period.

Revenue Recognition

Our revenue recognition policies are in compliance with Securities Exchange Commission (“SEC”) Staff Accounting Bulletin (“SAB”) 104 (codified in Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 605). Sales revenue, including the final 10% of the purchase price, is recognized after delivery is complete, customer acceptance of the product occurs and collectability is reasonably assured. Customer acceptance occurs after the customer puts the product through a quality inspection, which normally is completed within one to two weeks from customer receipt of the product. In case of sales contracts with FOB shipping terms, the customer is responsible for the cost of freight, and insurance and revenue is recognized when products are delivered to the carrier. In case of sales contracts with FOB destination terms, the Company is responsible for the cost of freight, and insurance and revenue is recognized when customer acceptance is received. The customer is responsible for installation and integration of our products into its end products. Payments received before satisfaction of all relevant criteria for revenue recognition are recorded as unearned revenue. Unearned revenue consists of payments received from customers prior to customer acceptance of our products.

Sales revenue represents the invoiced value of goods, net of value-added tax, or VAT. Our products sold and services provided in China are subject to VAT of 17% of gross sales price. This VAT may be offset by VAT paid by us on raw materials and other materials included in the cost of producing the finished product. We recorded VAT payable and VAT receivable net of payments in the financial statements. The VAT tax return is filed offsetting the payables against the receivables.

Segment Reporting

SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information” (codified in FASB ASC Topic 280), requires use of the “management approach” model for segment reporting. The management approach model is based on the way a company’s management organizes segments within a company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure or any other manner in which management disaggregates a company.

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Management determined our product lines – wind towers, bellows expansion joints and pressure vessels – constitute a single reportable segment under ASC 280. We operate in one business: the design and manufacture of highly engineered metal components for heavy industry. The manufacturing processes for our products, principally rolling and welding of raw steel materials, use the same production workers and engineering talent for design, fabrication, assembly and testing. Our products are characterized and marketed by their ability to withstand temperature, pressure, structural load and other environmental factors. Our products are used by major electrical utilities and large-scale industrial companies in China specializing in heavy industry, and our sales force sells our products directly to these companies, which utilize our components in their finished products. All of our long-lived assets for production are located in our facilities in Tieling, Liaoning Province, China, and operate within the same environmental, safety and quality regulations governing industrial component manufacturing companies. We established our subsidiary, Creative Wind Power, to market and sell our wind towers, which constitute the structural support cylinder for industrial wind turbines. Management believes the economic characteristics of our product lines, specifically costs and gross margin, will be similar as production increases and labor continues to be shared across products.

As a result, management views our business and operations for all product lines as a blended gross margin when determining future growth, return on investment and cash flows. Accordingly, management has concluded that we have one reportable segment under ASC 280 because: (i) all of our products are created with similar production processes, in the same facilities, under the same regulatory environment and sold to similar customers using similar distribution systems; and (ii) gross margins of all product lines have been converging and should continue to converge.

RESULTS OF OPERATIONS

The three months ended March 31, 2014, compared to the three months ended March 31, 2013

The following table presents the consolidated results of operations for the three months ended March 31, 2014 and 2013.

| | 2014 | | 2013 | |
|---------------------------------|-----------|------------|-----------|------------|
| | \$ | % of Sales | \$ | % of Sales |
| Net sales | 1,927,593 | 100 % | 252,819 | 100 % |
| Cost of goods sold | 1,538,078 | 80 % | 430,101 | 170 % |
| Gross profit (loss) | 389,515 | 20 % | (177,282) | (70) % |
| Operating expenses (income) | (338,167) | (18) % | 287,192 | 114 % |
| Income (loss) from operations | 727,682 | 38% | (464,474) | (184)% |
| Total non-operating expense | (276,726) | (14)% | (445,367) | (176)% |
| Income (loss) before income tax | 450,956 | 23% | (909,841) | (360)% |
| Income tax expense | - | - % | - | -% |
| Net income (loss) | 450,956 | 23% | (909,841) | (360)% |

NET SALES

Net sales for the three months ended March 31, 2014 increased to \$1.93 million from \$0.25 million for the comparable period of 2013, an increase of \$1.68 million or 662%. Net sales for the three months ended March 31, 2014, consisted of \$0.26 million in sales of bellows expansion joints, \$0.24 million in sales of pressure vessels including heat exchanger, \$1.36 million in sales of forging, and \$61,000 in other sales. Net sales for the comparable period of 2013 consisted of \$0.12 million in sales of bellows expansion joints, and \$0.13 million in other sales. Even though the 1st quarter of each year is typically our slow season due to the cold weather and Chinese New Year holidays, our sales increased in the three months ended March 31, 2014 compared with the same period of 2013 due to

our continuous effort to improve our sales force's effectiveness, expansion of our sales channels and development of new products, including the successful launching of new forging products.

COST OF GOODS SOLD

Cost of goods sold ("COGS") for the three months ended March 31, 2014 increased to \$1.54 million from \$0.43 million for the comparable period of 2013. COGS include material costs, primarily steel, labor and related overhead costs. The increased COGS was due primarily to increased production. We also faced increased raw material costs with respect to the production of all of our products due to overall inflation being experienced in China. COGS as a percentage of net sales was 80% in the three months ended March 31, 2014 compared to 170% for the 2013 period, the decrease in COGS to total sales was mainly due to increased production and sales of new forging products which had a higher gross margin in the three months ended March 31, 2014. In addition, our COGS included inventory impairment provision of \$201,900 (accounted for 10% of the sales) for the three months ended March 31, 2014, while we had \$94,600 inventory impairment provision (accounted for 37% of the sales) for the same period of 2013.

Table of Contents**GROSS PROFIT (LOSS)**

Gross profit for the three months ended March 31, 2014 increased to \$0.39 million from \$0.18 million gross loss for the 2013 period. Profit margin increased to 20% for the three months ended March 31, 2014 from (70)% for the 2013 period, as a result of increased sales and decreased COGS to total sales as described above.

OPERATING (INCOME) EXPENSES

Operating income for the three months ended March 31, 2014 increased to \$0.34 million from \$0.29 million operating expenses for the 2013 period. The increase in operating income was mainly due to a reversal of bad debt allowance of \$0.71 million as a result of successful collection of doubtful accounts receivable for the three months ended March 31, 2014. Operating income as a percentage of net sales for the three months ended March 31, 2014 was 18% compared to operating income of 114% of operating expenses as a percentage of net sales for the same 2013 period. Our G&A expenses increased to \$0.33 million in the three months ended March 31, 2014 from \$0.24 million in the same period of 2013, the increase was mainly due to our increased sales and expansion of business.

TOTAL NON-OPERATING EXPENSES

Total non-operating expenses for the three months ended March 31, 2014 was \$276,726 and consisted mainly of \$279,499 in interest expense, but was offset by net other income of \$2,773, compared to \$445,367 for the three months ended March 31, 2013, which consisted mainly of \$448,771 in interest expense, but was offset by \$3,404 net other income.

NET INCOME (LOSS)

Net income for the three months ended March 31, 2014 was \$0.45 million compared to net loss of \$0.91 million for the same 2013 period. Net income as a percentage of net sales for the three months ended March 31, 2014 was 23% compared to net loss as a percentage of net sales of 360% for the same 2013 period. The increase in net income was attributable to significantly increased sales and reversal of bad debt allowance.

LIQUIDITY AND CAPITAL RESOURCES

The three months ended March 31, 2014, compared to the three months ended March 31, 2013

Our operational and liquidity needs are funded primarily through cash flows from operations, short-term borrowings, shareholder contributions and financing through capital markets. The cash was used primarily in operations.

As of March 31, 2014, we had cash and equivalents of \$414,097, other current assets of \$11,986,121 and current liabilities of \$19,310,158. Working capital deficit was \$6,909,940 at March 31, 2014. The ratio of current assets to current liabilities was 0.64-to-1 as of March 31, 2014.

The following is a summary of cash provided by or used in each of the indicated types of activities during the three months ended March 31, 2014 and 2013:

| | 2014 | 2013 |
|-----------------------------|--------------|-----------|
| Cash provided by (used in): | | |
| Operating activities | \$ 1,731,694 | \$ 20,846 |
| Investing activities | (2,216) | (10,074) |
| Financing activities | (1,329,093) | (41,946) |

Net cash provided by operating activities was \$1,731,694 for the three months ended March 31, 2014, compared to \$20,846 for the same 2013 period. The increase in net cash provided in operating activities during the three months ended March 31, 2014 was due mainly to a significant increase in net income, improved collection on accounts receivables (we had cash inflow of \$1.06 million from collection of accounts receivables in the three months ended March 31, 2014 while we only had \$0.39 million in the same period of 2013), and less advance payment to suppliers.

Net cash used in investing activities was \$2,216 during the three months ended March 31, 2014 compared to net cash used in investing activities of \$10,074 for the same 2013 period. The cash used in investing activities in the three months ended March 31, 2014 and 2013 was for the payment for purchasing of property and equipment.

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Net cash used in financing activities was \$1,329,093 for the three months ended March 31, 2014, compared to net cash used in financing activities of \$41,946 for the same 2013 period. The cash outflow in the three months ended March 31, 2014 was for repayment of \$2.26 million for the short-term loans, offset with proceeds from advance from shareholder of \$926,546. In the three months ended March 31, 2013, the cash outflow resulted from advance to an officer/shareholder of \$41,946.

Our standard payment terms with our wind tower customers generally provide that 10% of the purchase price is due upon our deposit of restricted cash into a bank account as a contract guarantee, 20% upon our purchase of raw material for the order, 10% upon delivery of the base ring component of the wind towers, 30% upon delivery of the wind tower tube sections and 20% upon customer inspection and acceptance of the product, which customers normally complete within 1-2 weeks after delivery. As a common practice in the manufacturing business in China, payment of the final 10% of the purchase price is due no later than the termination date of the product warranty period, which can be up to 12 months from the customer acceptance date. For our bellows expansion joints and pressure vessels, payment terms are negotiated on a case-by-case basis and these payment percentages and terms may differ for each customer. We may experience payment delays from time to time of up to six months from the due date, but we expect to receive all payments despite any customer delays in payment. We do not anticipate any significant credit risk because the majority of our customers are large, well-capitalized state-owned and publicly traded utility and industrial companies with stable operations. Furthermore, we do not believe the delays have a significant negative impact on our liquidity as payment delays are very common in the manufacturing industry in China.

As of March 31, 2014, we had accounts receivable of \$6,012,558 (before bad debt allowance of \$3,776,839), of which \$120,935 was current, \$937,108 had aging over 30 days, \$588,048 had aging over 90 days, \$1,159,099 had aging over 180 days and \$3,207,368 had aging over 360 days.

Recent Accounting Pronouncements

In January 2014, FASB issued, Accounting Standards Update 2014-01, Investments—Equity Method and Joint Ventures (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects. The objective of this Update is to provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The adoption of this ASU will not affect the Company's financial statements.

In January 2014, FASB issued, Accounting Standards Update 2014-05, Service Concession Arrangements (Topic 853), The objective of this Update is to specify that an operating entity should not account for a service concession arrangement within the scope of this Update as a lease in accordance with Topic 840, Leases. Service concession arrangements may become more prevalent in the United States as public-sector entities seek alternative ways to provide public services on a more efficient and cost-effective basis. The amendments apply to an operating entity of a service concession arrangement entered into with a public-sector entity grantor when the arrangement meets certain conditions. The amendments in this Update should be applied on a modified retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. The modified retrospective approach requires the cumulative effect of applying this Update to arrangements existing at the beginning of the period of adoption to be recognized as an adjustment to the opening retained earnings balance for the annual period of adoption.

The amendments are effective for a public business entity for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of this ASU will not affect the Company's financial statements.

Off-Balance Sheet Arrangements

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

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Contractual Obligations

On September 21, 2009, we entered into a construction contract with a local authority, the Administration Committee for Liaoning Special Vehicle Production Base, or LSVPB, to build a plant for us. Under the terms of the construction agreement, LSVPB was responsible for the construction of the plant and we pledged the plant as collateral for our payment to LSVPB of \$1,944,151 (RMB 12,249,900) in plant construction costs in five equal annual installment payments starting in October 2010 with \$388,830 (RMB 2,449,980) as the first installment amount. In the fourth quarter of 2011, the Company received a subsidy from LSVPB of \$1.11 million (RMB 7,000,000) against the outstanding payment. In the first quarter of 2012, the Company repaid \$382,886 (RMB 2,410,000). During the three months ended March 31, 2014, the Company did not make any payments and was in default as of March 31, 2014. The Company expects to pay the outstanding amount of \$442,827 in full by October 2014.

On December 13, 2010, we entered into a loan with a lender for \$10 million. At the Lender's option, the principal amount of the note and all interest thereon shall be paid in either USD or RMB at an exchange rate of RMB 6.90 to USD 1.00 if paid on or before March 1, 2012, and thereafter at an exchange rate of RMB 6.30 to USD 1.00 to the Lender or any designee of Lender as provided to us in writing by Lender. The loan bore interest of 10% payable in advance at the beginning of each quarter with a maturity of March 1, 2012. The loan was amended to mature on March 1, 2013, and to decrease the interest rate to 8.5%, effective March 1, 2012, which interest shall be payable quarterly in advance. From March 1, 2012 through August 13, 2013, we were in default on interest payment that was required to pay in advance; we were also in default in payment of \$10 million loan due on March 1, 2013. The interest, from the date of the Default, was at the lesser of 24% or the maximum applicable legal rate. Accordingly, we used 24% as default interest rate from March 1, 2012 through August 13, 2013. After August 13, 2013, the interest rate on the \$10 million loan was 8.5% according to the Line of Credit Agreement described below. We had interest payable of \$3.84 million on this loan as of March 31, 2014.

Through a new Line of Credit Agreement entered with the same lender on August 17, 2013, this default loan became payable upon Note-holder's request and the interest rate at 8.5% after August 13, 2013. The Promissory Note entered on August 17, 2013 along with an Escrow Agreement was for a Line of Credit available to us of up to \$10 million. The lender deposits the required amount into an escrow account each time before disbursement, and the escrow agent disburses some or all of the deposit from time to time as directed in writing by the lender for advancing us to pay expenses that are approved by the lender. The applicable interest rate for this line of credit is 3% during the first six months following each advance, and 0% thereafter, to be paid on the first day of each month, with maturity upon Note-holder's request. The promissory note has a default rate of 24%. As of March 31, 2014, we borrowed \$0.65 million from the credit line and accrued interest of \$8,939.

On December 14, 2011, we entered into a 3% promissory note for \$50,000 for paying legal expenses, maturing on February 1, 2012. The note is past due with default interest at 6% accrued subsequent to February 1, 2012. As of March 31, 2014, the Company had accrued interest of \$6,690 on this note.

At March 31, 2014, we had short-term loans outstanding of \$10,688,951, and total accrued interest of \$3.85 million.

Pending Litigation

As of March 31, 2012, Creative Bellows had a case pending in arbitration for the recovery of approximately one million RMB. Creative Bellows filed the arbitration proceeding for a breach of contract by Dongbei Jincheng Construction Co., Ltd., a plant construction contractor. On March 14, 2013, Dongbei JinCheng filed a complaint in the Tieling Intermediate People's Court against the Company, alleging that the Company owes it construction costs in the amount of RMB 2,400,099.82 plus RMB 700,000 interest and RMB 28,176 arbitration expenses. On March 19, 2013, the company filed a counterclaim against Dongbei JinCheng, alleging that Dongbei JinCheng breached the contract by

failing to complete the construction work according to quality specifications. The Company sought in RMB 2,197,131.53 monetary damages. On October 9, 2013, Dongbei JinCheng was ordered by the court to pay RMB 27,000 examination fee, RMB 77,413.89 repair costs and RMB 13,000 design and appraisal costs to the Company. On October 10, 2013, the Company filed an appeal against Dongbei JinCheng to Liaoning High People's Court in order to obtain higher damages. As of this report date, this case is under review by Liaoning High People's Court.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not required.

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Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, our principal executive officer and principal financial officer, respectively, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934 (the “Exchange Act”) as of the end of the period covered by this report. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2014, our disclosure controls and procedures were not effective as of such date because of a material weakness identified in our internal control over financial reporting related to our internal level of U.S. GAAP expertise. We lack sufficient personnel with the appropriate level of knowledge, experience and training in U.S. GAAP for the preparation of financial statements in accordance with U.S. GAAP. None of our internal accounting staff, including our Chief Financial Officer, that are primarily responsible for the preparation of our books and records and financial statements in compliance with U.S. GAAP holds a license such as Certified Public Accountant in the U.S., nor have any attended U.S. institutions or extended educational programs that would provide enough of the relevant education relating to U.S. GAAP.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the quarter ended March 31, 2014, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As of March 31, 2012, Creative Bellows had a case pending in arbitration for the recovery of approximately one million RMB. Creative Bellows filed the arbitration proceeding for a breach of contract by Dongbei Jincheng Construction Co., Ltd., a plant construction contractor. On March 14, 2013, Dongbei JinCheng filed a complaint in the Tieling Intermediate People's Court against the Company, alleging that the Company owes it construction costs in the amount of RMB 2,400,099.82 plus RMB 700,000 interest and RMB 28,176 arbitration expenses. On March 19, 2013, the company filed a counterclaim against Dongbei JinCheng, alleging that Dongbei JinCheng breached the contract by failing to complete the construction work according to quality specifications. The Company sought in RMB 2,197,131.53 monetary damages. On October 9, 2013, Dongbei JinCheng was ordered by the court to pay RMB 27,000 examination fee, RMB 77,413.89 repair costs and RMB 13,000 design and appraisal costs to the Company. On October 10, 2013, the Company filed an appeal against Dongbei JinCheng to Liaoning High People's Court in order to obtain higher damages. As of May 9, 2014, this case is under review by Liaoning High People's Court.

On January 5, 2012, the Company filed an amended complaint in the United States District Court for the Southern District of New York against the NASDAQ Stock Market, LLC and NASDAQ OMX Group, referred to collectively as NASDAQ. The Company alleged that NASDAQ's actions resulted in a violation of the Company's equal protection rights under the United States Constitution, amounted to selective prosecution and intentionally breached the Company's attorney-client privilege. The Company sought a permanent injunction enjoining NASDAQ from using its discriminatory policies against the Company and also sought at least \$300 million in monetary damages. On January 31, 2012, the amended complaint was dismissed on the basis of a lack of subject matter jurisdiction. The Company decided not to file an appeal to the Second Circuit Court of Appeals so it could focus on its appeal to the SEC of NASDAQ Listing Qualifications determination to delist the Company's common stock.

The Company applied to the SEC for a review of the final delisting decision made by NASDAQ Listing Qualifications. On July 11, 2013, the Securities Exchange Commission ("SEC") reversed the 2011 delisting of the Company's stock on the NASDAQ Stock Market, LLC.

On March 21, 2012, Fensterstock & Partners LLP, filed a complaint in the Supreme Court of the State of New York against the Company, and others, seeking \$400,808 in unpaid legal fees in connection with Fensterstock's representation of the Company in its suit against the NASDAQ Stock Market, LLC and NASDAQ OMX Group. The Company has filed an answer to the complaint, denying the material allegations of the complaint. Fensterstock filed a motion for partial summary judgment on its claim for "account stated" and the Company then filed papers in opposition to Fensterstock's motion for partial summary judgment. The Company intends to continue to defend itself against the claims asserted. On October 9, 2012, the court awarded a judgment in favor of Fensterstock & Partners LLP in the amount of 423,333.26 (original due of \$400,808 plus accrued interest from March 1, 2012 through August 24, 2012) plus interest at 9% until paid in full.

We may occasionally become involved in various lawsuits and legal proceedings arising in the ordinary course of business. Litigation is subject to inherent uncertainties and an adverse result in these or other matters that may arise from time to time could have an adverse effect on our business, financial condition or operating results. We are currently not aware of any such legal proceedings, aside from those listed above, or claims that will have, individually or in the aggregate, a material adverse effect on our business, financial condition or operating results.

Item 1A. Risk Factors

You should consider carefully the factors discussed in the “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect our business.

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

None.

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Item 3. Defaults Upon Senior Securities

On December 13, 2010, the Company entered into a loan with a lender for \$10 million. At the Lender's option, the principal amount of the note and all interest thereon shall be paid in either USD or RMB at an exchange rate of RMB 6.90 to USD 1.00 if paid on or before March 1, 2012, and thereafter at an exchange rate of RMB 6.30 to USD 1.00 to the Lender or any designee of Lender as provided to the Company in writing by Lender. The loan bore interest of 10% payable in advance at the beginning of each quarter with a maturity of March 1, 2012. The loan was amended to mature on March 1, 2013, and to decrease the interest rate to 8.5%, effective March 1, 2012, which interest shall be payable quarterly in advance. From March 1, 2012 through August 13, 2013, the Company was in default on interest payment that was required to pay in advance; the Company was also in default in payment of \$10 million loan due on March 1, 2013. Therefore the interest, from the date of the Default, was at the lesser of 24% or the maximum applicable legal rate. The Company used 24% as default interest rate from March 1, 2012 through August 13, 2013. After August 13, 2013, the interest rate on the \$10 million loan was 8.5% according to the Line of Credit Agreement described below. The Company had interest payable of \$3.84 million as of March 31, 2014.

Through a new Line of Credit Agreement entered with the same lender on August 17, 2013, this default loan became payable upon Note-holder's request and the interest rate at 8.5% after August 13, 2013. The Promissory Note entered on August 17, 2013 along with an Escrow Agreement was for a Line of Credit available to the Company of up to \$10 million. The lender deposits the required amount into an escrow account each time before disbursement, and the escrow agent disburses some or all of the deposit from time to time as directed in writing by the lender for advancing the Company to pay expenses that are approved by the lender. The applicable interest rate for the amount borrowed under this line of credit is 3% during the first six months following each advance, and 0% thereafter, to be paid on the first day of each month, with maturity upon Note-holder's request. The promissory note has a default rate of 24%. As of March 31, 2014, the Company borrowed \$0.65 million from the credit line and accrued interest of \$8,939.

On December 14, 2011, the Company entered into a 3% promissory note with a lender for \$50,000, maturing on February 1, 2012, for the payment of its legal expenses. As of March 31, 2014, the Company had accrued interest of \$6,690 on this note. The note is past due with default interest at 6% accrued subsequent to February 1, 2012.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

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SIGNATURES

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

CLEANTECH INNOVATIONS, INC.
(Registrant)

Date: May 12, 2014

By: /s/ Bei Lv
Bei Lv
Chief Executive Officer
(Principal Executive Officer)

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EXHIBIT INDEX

| Exhibit No. | Document Description |
|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1 † | <u>Certification of President pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 31.2 † | <u>Certification of Acting Chief Accountant pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1 ‡ | <u>Certifications of President and Acting Chief Accountant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 101.INS† | XBRL Instance Document |
| 101.SCH† | XBRL Schema Document |
| 101.CAL† | XBRL Calculation Linkbase Document |
| 101.DEF† | XBRL Definition Linkbase Document |
| 101.LAB† | XBRL Label Linkbase Document |
| 101.PRE† | XBRL Presentation Linkbase Document |

Management contract or compensatory plan, contract or arrangement

† Filed herewith

‡ Furnished herewith

