APOLLO SOLAR ENERGY, INC.
Form 10-Q
August 14, 2012

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 June 30, 2012

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

For the transition period from __________ to ____________

Commission File Number: 000-12122

APOLLO SOLAR ENERGY, INC.
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	84-0601802 (I.R.S. Employer Identification No.)

No. 485 Tengfei Third,
Shuangliu Southwest Airport Economic Development Zone,
Shuangliu, Chengdu
People's Republic of China, 610207
(Address of principal executive offices)

Registrant's Telephone Number, Including Area Code: +86 (28) 8562-3888

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

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 ý No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company ý

(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 Act). Yes o No ý

There were 49,377,038 shares of common stock outstanding as of August 14, 2012.

APOLLO SOLAR ENERGY, INC.

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For the Quarterly Period Ended June 30, 2012

APOLLO SOLAR ENERGY, INC
CONSOLIDATED BALANCE SHEETS

	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current Assets		
Cash	$427,287	$363,771
Accounts receivable	841,754	804,577
Inventories	3,495,120	4,065,987
Prepaid expenses and other current assets	1,768,194	1,001,660
Total Current Assets	6,532,355	6,235,995
Property, machinery and mining assets, net	17,188,944	20,370,831
Assets held for sale	924,280	924,765
Non-marketable investment	55,477	55,506
Investment in and advances to Joint Venture	5,216,212	581,963
Total Non-current Assets	23,384,913	21,933,065
Total Assets	$29,917,268	$28,169,060
LIABILITIES AND EQUITY		
Current Liabilities		
Short-term loans	$6,900,570	$4,050,374
Account payable - trade	265,218	202,853
Account payable - construction vendors	1,425,454	1,493,155
Accrued expenses and other current liabilities	2,405,594	2,677,948
Due to stockholders and related parties	173,158	214,213
Total Current Liabilities	11,169,994	8,638,543
Stockholders' Equity		
Preferred stock:		
$0.001 par value, 25,000,000 shares authorized; 0 shares issued and outstanding as of June 30, 2012 and December 31, 2011	-	-
Common stock:		
$0.001 par value, 100,000,000 shares authorized; 51,795,961 shares issued and outstanding as of June 30, 2012 and December 31, 2011	51,796	51,796
Additional paid-in capital	32,879,655	32,609,043
Treasury stock 2,418,923 shares at cost	(5,216,770)	(5,216,770)
Accumulated deficit	(11,940,865)	(10,897,576)
Accumulated other comprehensive income	2,973,458	2,984,024
Total Stockholders' Equity	18,747,274	19,530,518
Total Liabilities and Stockholders' Equity	$29,917,268	$28,169,061

See accompanying notes to the consolidated financial statements

APOLLO SOLAR ENERGY, INC
CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	For the Three months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Sales	$ 988,346	$ 2,940,118	$ 2,860,380	$ 6,723,338
Cost of goods sold	(1,574,128)	(2,167,917)	(3,342,282)	(5,598,073)
Gross profit (loss)	(585,782)	772,201	(481,902)	1,125,265
Operating expenses:				
General and administrative expenses	738,513	676,488	1,426,533	1,577,268
Selling expense	52,788	104,930	109,686	175,203
Research and development expenses	379,355	259,762	534,925	290,572
Total operating expenses:	1,170,656	1,041,180	2,071,144	2,043,043
Operating loss	(1,756,438)	(268,979)	(2,553,046)	(917,778)
Other income (expense)				
Interest income (expense), net	(114,320)	(55,368)	(253,216)	687,802
Equity in loss of Joint Venture	(66,151)	(135,750)	(174,748)	(247,593)
Gain on investment in Joint Venture	2,040,651		2,040,651	
Total other income (expense)	1,860,180	(191,118)	1,612,687	440,209
Income(loss) before provision for income taxes	103,742	(460,097)	(940,359)	(477,569)
Provision for income taxes (credit)	102,930	(28,712)	102,930	(125,778)
Net income (loss)	812	(431,385)	(1,043,288)	(351,791)
Foreign currency translation adjustment	(39,516)	313,399	(10,566)	499,538
Comprehensive income (loss)	$ (38,704)	$ (117,986)	$ (1,053,855)	$ 147,747
Earnings (loss) per share				
Basic	$ 0.00	$ (0.01)	$ (0.02)	$ (0.01)
Diluted	$ 0.00	$ (0.01)	$ (0.02)	$ (0.01)
Weighted average shares outstanding				
Basic	51,795,961	50,159,169	51,795,961	50,159,169
Diluted	51,795,961	50,159,169	51,795,961	50,159,169

See accompanying notes to the consolidated financial statements

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APOLLO SOLAR ENERGY, INC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30, 2012	2011
Cash flows from operating activities:		
Net Loss	$ (1,043,289)	$ (351,791)
Adjustments to reconcile net loss to net cash provided by(used in) operating activities:		
Stock-based compensation	270,611	321,728
Interest income from related party loan	-	(837,359)
Gain on investment in Joint Venture	(2,040,651)	-
Loss in equity of Joint Venture	174,748	247,593
Deferred tax assets	-	(121,221)
Inventory allowance	324,831	-
Depreciation and amortization	468,598	486,035
Changes in operating assets and liabilities:		
Accounts receivable	(37,637)	(366,381)
Inventory	244,462	2,334,284
Prepaid expenses and other current assets	(767,814)	467,736
Accounts payable-trade	62,534	(203,428)
Accounts payable-construction	(66,983)	(1,090,806)
Accrued expenses and other current liabilities	(271,729)	1,010,440
Net cash provided by(used in) operating activities	(2,682,319)	1,896,830
Cash flows from investing activities:		
Purchase of property and equipment	(87,815)	(91,236)
Net cash used in investing activities	(87,815)	(91,236)
Cash flows from financing activities:		
Short-term bank loans	2,855,126	(380,069)
Payment to shareholders	-	(1,619,527)
Due to related parties	(20,748)	52,307
Net cash provided by (used in) financing activities	2,834,378	(1,947,289)
Effect of exchange rate changes on cash	(728)	64,707
Net increase (decrease) in cash	63,516	(76,988)
Cash at beginning of period	363,771	2,676,176
Cash at end of period	$ 427,287	$ 2,599,188
Supplemental disclosure of cash flow information		
Income tax paid in cash	$ 102,930	$ 11,829
Interest expense	$ 222,311	$ 135,389
	$ -	$ 5,273,253

Treasury stock acquired in exchange for loans from related parites				
Assets transferred to Joint Venture	$	2,793,536	$	-

See accompanying notes to the consolidated financial statements

APOLLO SOLAR ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2011
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Apollo Solar Energy, Inc. (the “Company) reflect all material adjustments consisting of only normal recurring adjustments which, in the opinion of management, are necessary for a fair presentation of results for the interim periods. Certain information and footnote disclosures required under accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and those estimates. Estimates that are particularly susceptible to change include assumptions used in determining the fair value of securities owned and non-readily marketable securities.

The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the entire year or for any future period.

The Company’s functional currency is the Chinese Renminbi (“RMB”); however, the accompanying financial statements have been translated and presented in United States Dollars (“USD”).

Going concern
The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the accompanying financial statements, the Company has negative working capital of $4,637,639, did not generate cash from its operations, and has had operating losses during past two years. These circumstances, among others, raise substantial doubt about the Company’s ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 2. INVENTORIES

Inventories are valued at the lower of cost or net realizable value with cost determined on the weighted-average method. Work in progress and finished goods are composed of direct material, direct labor and a portion of manufacturing overhead. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs to complete and dispose. The Company recorded an inventory mark-down of $324,831 and $0 for the six months ended June 30, 2012 and 2011, respectively.

NOTE 2. INVENTORIES (Continued)

Inventories consist of the following:

	As of June 30, 2012		December 31, 2011	
Raw Materials	$	756,251	$	719,635
Work-in-progress		1,125,401		1,322,666
Finished goods		1,613,468		2,023,686
Total	$	3,495,120	$	4,065,987

NOTE 3. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist following:

	June 30,2012		December 31,2011	
Advances for purchases	$	1,608,044	$	908,760
Other receivable		153,968		92,900
Other prepaid expenses		6,182		-
Total	$	1,768,194	$	1,001,660

NOTE 4. RELATED PARTIES TRANSACTIONS AND BALANCES

The breakdown of due from/due to related parties consists of the following:

	As of June 30, 2012		December 31, 2011	
Due from (to) Xinju	$	38,063	$	(2,992)
Due to shareholders		(211,221)		(211,221)
Total	$	(173,158)	$	(214,213)

Due to shareholders and due to/from Xinju are non-interest bearing and due on demand.

NOTE 5. EQUITY METHOD INVESTMENT IN JOINT VENTURE

On November 9, 2009, Sichuan Apollo Solar Science & Technology Co. Ltd. (“Sichuan Apollo”), a wholly-owned foreign enterprise of the Company, entered into a joint venture agreement (the “JV Agreement”) with Bengbu Design & Research Institute for Glass Industry (“Bengbu”) and a local Chinese government agency (the “Agency”). The Joint Venture (“JV”) was formed to conduct research and development related to glass used in the production of thin film solar cells and manufacture thin film solar cells. As of June 30, 2012 the JV had not commenced the production of thin film solar cells. The Company accounts for its 35% interest in JV under the equity method of accounting.

Under the terms of the agreement, the JV was to be formed with an aggregate cash capital contribution of RMB 142,800,000 (approximately $22 million) by Bengbu and the Agency and the contribution by Sichuan Apollo’s of assets consisting of land, a manufacturing plant, equipment and three patents with a net book value of approximately $1.7 million with a fair market value of RMB 49,980,000 (approximately $7.3 million). Benghu and the Agency own an aggregate of 65% of the JV and Sichuan Apollo owns the remaining 35%. In addition, under the terms of the agreement, debt of Sichuan Apollo aggregating RMB 37,170,000 (approximately $5.4 million) owed to the Agency was assigned to the JV. The value of the net assets contributed by Sichuan Apollo was equal to the proportionate value of the total capital contribution to be made to the JV taking into consideration the cash contribution by the other parties. The assets were valued by the Company’s management giving consideration to the valuation services provided by an independent third party. In accordance with ASC 805-40, Sichuan Apollo has reported a gain on the difference between the initial cost of the investment and the Company’s proportionate share of the fair value of the JV’s net equity, which, if treated as a consolidated subsidiary, would have resulted in negative goodwill to be recorded as a gain. From the year ended December 31, 2009 to June 30, 2012, the Company contributed net assets of approximately RMB 29 million (equivalent to $4.7 million) and a RMB 37,170,000 (equivalent to $5.9 million) loan payable to the Agency was assigned to the JV. This resulted in an excess of the proportionate share of the JV’s net assets at fair market value over the cost of the assets contributed of RMB 44.8 million (equivalent to $7.1 million). The Company’s equitable share of the excess was reported as income on the statement of operations for the six months ended June 30, 2012. As of June 30, 2012, all parties has finished the total capital contribution of RMB142,800,000 (approximately $22.7 million) to JV per agreement. All gain has been recognized as of June 30, 2012.

Summarized financial information for our investment in the JV assuming a 100% ownership interest is as follows:

	June 30, 2012	June 30, 2011
Statement of operations		
Revenues	$ -	$ 3,141
Cost of sales	-	1,689
Gross profit	-	1,443
Operating Loss	(499,280)	(707,410)
Loss before income tax	(499,280)	(707,410)

NOTE 6. ACCRUED EXPENSES, TAXES AND OTHER CURRENT LIABILITIES

Accrued expenses, taxes and other current liabilities are listed as below:

	June 30, 2012	December 31, 2011
Accrued interest	$ 823,840	$ 819,418
Salaries and benefits	192,523	275,194
Other taxes	269,271	715,277
Professional fees	73,541	102,779
Accrued R&D expenses	625,000	375,000
Other payables	421,419	390,280
Total	$ 2,405,594	$ 2,677,948

NOTE 7. SHORT-TERM LOAN

Short-term bank loans consist of the following loans collateralized by assets of the company:

	June 30, 2012	December 31, 2011
1) Loan payable to Chengdu Xihang Gang Construction & Investment Co., Ltd. due on demand, without interest collateralized by certain plant equipment of Sichuan Apollo	$654,631	$654,974
2) Loan payable to Bank of Communication, Chengdu branch due on July 29, 2012, with interest at 8.53% per annum, collateralized by the buildings and land use right of Diye, which was paid in full on July 27, 2012	317,012	317,179
3) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on August 25, 2012, with interest at 7.74% per annum, collateralized by the buildings of Sichuan Apollo	792,531	792,947
4) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on September 19, 2012, with interest at 7.74% per annum, collateralized by the buildings of Sichuan Apollo	697,427	697,794
5) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on December 25, 2012,with interest at 7.74% per annum, collateralized by the buildings of Sichuan Apollo	1,585,062	1,585,894
6) Loan payable to Bank of China, Xihanggang Branch, Chengdu, due on March 28, 2012, with interest of 6.73% per annum. The loan was paid in full in March 2012.	-	1,586
7) Loan payable to Wuhan Economic Development Group through Industrial and Commercial Bank of China, Huangpu Branch, Wuhan due on October 31, 2012,with interest at 7.5% per annum, collateralized by Sichuan Xinlong's 100% ownership in Shimian	1,268,050	-
8) Loan payable to Bo Hai Bank, Chengdu Branch, due on August 23, 2012,with interest at 7.625% per annum, collateralized by the buildings of Sichuan Apollo	1,585,062	-
9) Loan payable to Bank of China, Xihanggang Branch, Chengdu, due on demand	795	-
	$6,900,570	$4,050,374

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NOTE 8. TAXES

Corporation income tax

The Company is incorporated in the United States of America and is subject to United States federal taxation. No provisions for income taxes have been made, as the Company had no U.S. taxable income for the three and six months ended June 30, 2012 and 2011.

The Company’s Chinese subsidiaries are governed by the Income Tax Law of the PRC concerning the privately run and foreign invested enterprises, which are generally subject to tax at a statutory rate of 25% on income reported in the statutory financial statements after appropriate tax adjustments.

On July 16, 2009, the Company’s subsidiary, Sichuan Xinlong, received government approval regarding the High-Tech Enterprise Certificate which allows the Company to enjoy a favorable tax rate of 15% effective January 1, 2009 through December 31, 2011. The Company is in the process of applying to renew this certificate for 2012 and the following years.

Based on management's present assessment, the Company has determined that it is more likely than not a deferred tax asset attributable to the future utilization of the net operating loss carry-forward as of June 30, 2012 will not be realized. Accordingly, the Company has provided a 100% allowance against the deferred tax asset in the financial statements at June 30, 2012. The Company will continue to review this valuation allowance and make adjustments as appropriate.

The Company has net operating loss carry-forwards in China and United States of approximately $3 million and $8 million, respectively, which expire between 2012 and 2022. The Company has a deferred tax asset resulting from the tax loss carry-forwards of approximately $4 million for which the Company has provided a 100% valuation allowance.

The comparison of income tax expense at the U.S. statutory rate of 35% in 2012 and 2011, to the Company’s effective tax is as follows:

	Six months ended June 30	
	2012	2011
U.S. Statutory rate of 35%	$ (329,126)	$ (167,148)
Tax rate difference between China and U.S.	184,940	159,885
Change in valuation allowance	144,186	(112,651)
Tax paid for prior year	102,930	-
Permanent difference	-	(5,864)
Effective tax	$ 102,930	$ (125,778)

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NOTE 8. TAXES (Continued)

The provisions for income taxes are summarized as follows:

	Six months ended June 30 2012	Six months ended June 30 2011
Current	$ 102,930	$ 11,872
Deferred	-	(137,650)
Total	$ 102,930	$ (125,778)

Value added tax ("VAT")

Enterprises or individuals who sell commodities, engage in repair and maintenance or import or export goods in the PRC are subject to a value added tax in accordance with the PRC laws. The value added tax standard rate is 17% of the gross sales price. A credit is available whereby VAT paid on the purchases of semi-finished products or raw materials used in the production of the Company's finished products can be used to offset the VAT due on the sales of the finished products.

As of June 30, 2012 and December 31, 2011, the Company had VAT tax receivable of $66,413 and payable of $62,511, respectively.

NOTE 9. PRC STATUTORY RESERVES

In accordance with the PRC Companies Law, the Company was required to transfer 10% of its profit after tax, as determined in accordance with accounting standards and regulations of the PRC, to the statutory surplus reserve. The statutory surplus reserve is non-distributable. As of June 30, 2012 and December 31, 2011, the Company did not accumulate any statutory reserve due to the accumulated deficit.

NOTE10. BUSINESS SEGMENTS

For the six months ended June 30, 2012,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	$ 174,532	$ 2,685,848	$ -	$ -	$ 2,860,380
Operating loss	(571,237)	(1,283,234)	(113,228)	(585,347)	(2,553,046)
Depreciation and amortization	356,092	96,242	16,263	-	468,597
Capital expenditures	$ 28,220	$ 57,263	$ 2,332	$ -	$ 87,815

For the six months ended June 30, 2011,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	$ -	$ 6,723,338	$ -	$ -	$ 6,723,338
Operating loss	(382,327)	130,921	(150,874)	(515,498)	(917,778)
Depreciation and amortization	352,987	117,272	15,776	-	486,035
Capital expenditures	$ 15,434	$ 22,590	$ 53,212	$ -	$ 91,236

For the three months ended June 30, 2012,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	$ 18,861	$ 969,485	$ -	$ -	$ 988,346
Operating loss	(154,440)	(1,265,620)	(55,602)	(280,776)	(1,756,438)
Depreciation and amortization	196,103	25,875	8,088	-	230,066
Capital expenditures	$ 26,713	$ 46,935	$ 668	$ -	$ 74,316

For the three months ended June 30, 2011,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	$ -	$ 2,940,118	$ -	$ -	$ 2,940,118
Operating loss	(177,630)	267,662	(49,184)	(309,826)	(268,978)
Depreciation and amortization	148,601	88,502	7,917	-	245,020
Capital expenditures	$ 4,917	$ 4,057	$ 13,457	$ -	$ 22,431

NOTE 11. CONCENTRATIONS

For the six months ended June 30, 2012, three major customers accounted for approximately 20%, 18% and 10% of total sales separately. Five vendors accounted for approximately 43%, 12%, 11%, 10% and 10% of total purchase separately.

For the six months ended June 30, 2011, three major customers accounted for approximately 25%, 17% and 12% of total sales separately. At June 30, 2011, two customers accounted for 24% and 22% of total accounts receivable separately.

For the six months ended June 30, 2012, 10% of sales were made to customers in North America and 88% of sales were made to customers in Asia.

For the six months ended June 30, 2011, 27% of sales were made to customers in North America and 73% of sales were made to customers in Asia.

NOTE 11. CONCENTRATIONS (Continued)

For the three months ended June 30, 2012, two major customers accounted for approximately 27% and 13% of total sales separately. Five vendors accounted for approximately 23%, 20%, 19%, 18% and 12% of total purchase separately.

For the three months ended June 30, 2011, two major customers accounted for approximately 39% and 11% of total sales separately.

For the three months ended June 30, 2012, 98% of sales were made to customers in Asia.

For the three months ended June 30, 2011 11.5% of sales were made to customers in North America and 88.5% of sales were made to customers in Asia.

NOTE 12 SUBSEQUENT EVENTS

The Company has reviewed its subsequent events through the date these financial statements were issued and has determined that no additional material subsequent events have occurred through such date.

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

The following discussion contains forward-looking statements that involve risks and uncertainties. Forward-looking statements include, but are not limited to, statements regarding future events, our plans and expectations and financial projections. Our actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed elsewhere in this Form 10-Q and in our Annual Report on Form 10-K filed on May 16, 2012. Unless the context otherwise requires, the terms "we," the "Company," "us," or "Apollo" refers to Apollo Solar Energy, Inc. and our wholly-owned subsidiaries and variable interest entities.

Overview

We are a China-based vertically integrated refiner of tellurium, or Te, and high-purity tellurium-based metals for specific segments of the electronic materials market. Our main expertise is in the production of Te-based compounds used to produce thin-film solar cells, cell modules and solar electronic products. While no reserves under the SEC's Industry Guide 7 can currently be delineated at our properties, we believe that the tellurium to be used in our products in the future will be primarily sourced from our Dashuigou project located in Sichuan Province, PRC. In addition, we expect to source tellurium from another property in Shimian, Majiagou, PRC, through variable interest entity agreements, or the VIE Agreements, executed in April, 2009, with Sichuan Xinju Mineral Resources Development Corporation and certain of its shareholders holding 51.6619% of its voting stock, which shareholders are our direct or indirect employees. Under the terms of the VIE Agreements, we have been granted the exclusive exploration and mining rights to these two projects in accordance with a license granted by the Chinese government, which extends through January, 2013 for mining activities at our Dashuigou property, through May 2013 for mining activities at our Majiagou property, and through January 2013. for exploration activities at our Dashuigou property, subject to potential renewal thereafter.

Currently, tellurium is produced as a by-product in the process of processing copper and other metals. As a result, costs are high. We believe that the Dashuigou and Majiagou projects are the only two known deposits in the world in which tellurium, one of the rarest metallic elements on earth, is the primary commodity of economic interest. By the end of 2012, we plan to obtain approximately 50% to 60% of the tellurium necessary for our products from the Dashuigou and Majiagou projects and believe this ability to be a significant competitive advantage because the cost of tellurium sourced from our own properties will be substantially lower than that purchased from an outside third party. We will source the remaining 40% to 50% of our tellurium needs from third-party suppliers with whom we have established good business relationships over the past few years. By vertically integrating our processes, we believe we are able to achieve significant operating efficiencies and produce high-quality products that offer cost and quality benefits to our customers. Currently, we are able to procure raw materials from the Dashuigou and Majiagou projects at a significant discount to prevailing market price.

Our refining operations are currently based in a 330,000 square foot facility in Chengdu, Sichuan Province, PRC. We expect this facility to eventually have the capacity to produce more than 300 tons of high-purity photovoltaic cell materials and 42 other types of electronic materials. Future expansion of this facility in vacant land leased to the Company will have a capacity to produce up to an additional 350 tons of high-purity photovoltaic cell materials.

We are currently in the exploration stage of operations in accordance with the requirements of SEC Industry Guide 7. However, we believe we are unique in that we expect to both mine and refine our tellurium-based products, with primary refining capabilities as provided by Sichuan Xinju Mineral Resources Development Corporation pursuant to the VIE Agreements, and secondary refining capabilities directly through our Company. Our primary refining capabilities are such that we can treat metal concentrates (containing, for example, as little as 50% of the metals of interest), and extract and refine the metals of interest so that they can be fed to our secondary refining operations, where we attain a higher level of purity. Because we expect to mine the raw material in the future, and perform both refining functions, both directly and through our VIE Arrangement, we consider ourselves a supplier that will in the future have uniquely integrated capabilities. Our end-products are tellurium, cadmium, zinc and related compounds of 99.999% (five nines, or 5N) purity or above. Our products are critical precursors in a number of electronic applications, including the rapidly-expanding thin-film photovoltaic, or PV, market.

Thin film technologies, because of their relatively low usage of raw materials when compared with traditional silicon-based photovoltaic technologies, offer a potential cost advantage in the marketplace. Accordingly, we believe these technologies are beginning to gain an ever increasing foothold in the market.

Our Variable Interest Entity Agreements

As illustrated in the diagram below, we entered into various exclusive contractual arrangements on April 10, 2009 with Sichuan Xinju Mineral Resources Development Corporation, or the VIE, and certain of its shareholders who are our direct or indirect employees and who collectively own 51.6619% of the VIE. Among other things, these VIE Agreements granted to our wholly-owned subsidiary a first option to purchase the exploration rights related to the Dashuigou area property and the mining rights related to that certain tellurium and bismuth property in Shimian Majiagou, which rights we collectively referred to as the Exploration Business. Additionally, the VIE and certain of its shareholders who collectively own 51.6619% of the VIE granted to our wholly-owned subsidiary an exclusive right to purchase all of the products produced from the Exploration Business for a specified period of time. As a result, we consolidate the financial results of the VIE related to the Exploration Business pursuant to FASB ASC 810-10, “Consolidation.”

(1) Agreements that provide us with effective control over Sichuan Xinju Mineral Resources Development Co. Ltd., or the VIE, include a purchase option agreement, a business operations agreement and an exclusive technical and consulting agreement.

The agreements between the VIE and our other affiliated entities or persons are summarized below:

- First Option Exclusive Acquiring Agreement among Sichuan Xinlong Tellurium Industry & Technique Co., Ltd., Sichuan Xinju Mineral Resources Development Co., Ltd., Renyi Hou and Ling Yong, which grants to our wholly-owned subsidiary a first option to purchase the Mining Business at such time as the purchase becomes advisable, permissible and in our best interest.

- Exclusive Sales Agreement between Sichuan Xinlong Tellurium Industry & Technique Co., Ltd. and Sichuan Xinju Mineral Resources Development Co., Ltd., which grant to our wholly-owned subsidiary the exclusive right to buy all of the output of the Mining Business.

- Business Operation Agreement among Sichuan Xinlong Tellurium Industry & Technique Co., Ltd., Sichuan Xinju Mineral Resources Development Co., Ltd., Renyi Hou and Ling Yong, which imposes certain restrictions and obligations on the VIE and certain of its shareholders to support the VIE arrangement, including refraining from competing with our business and modifying the business operations of the VIE without the prior consent of our wholly-owned subsidiary.

- Exclusive Technical and Consulting Agreement between Sichuan Xinlong Tellurium Industry & Technique Co., Ltd. and Sichuan Xinju Mineral Resources Development Co., Ltd., which requires the VIE to provide certain technical and consulting services exclusively to our wholly-owned subsidiary in connection with the Mining Business. Our wholly-owned subsidiary agrees to provide up to $6.0 million in investing funding to the VIE in connection with its operation of the Mining Business, on such terms as the parties shall agree from time to time.

Results of Operations

Sales

Sales for the three months ended June 30, 2012 were $988,346, compared to the sales of $2,940,118 in the same period in 2011, a decrease of $1,951,772 or approximately 66.4%. Sales for the six months ended June 30, 2012 were $2,860,380, compared to the sales of $6,723,338 in the same period in 2011, a decrease of $3,862,958 or approximately 57.5%. The primary reasons for the reduction in sales were:

- Decrease in sales from overseas due to financial crisis in Europe and slow than expected recovery of economy in USA.

- Decrease in the selling price of Seleniumdue to weak demand.

- Decrease in quantity of the product purchased by our customers due to uncertainty in the economy.

Gross profit

Although our sales fell by 66.4% and 57.5% in the three and six months ended June 30, 2012, compared to the same period of year 2011, our cost of sales decreased by only 27.4% and 40.3% in the three and six months ended June 30, 2012 comparing to the same period of year 2011. The disparity was attributable to increases in the cost of raw materials that we were unable to pass along to our customers. As a result, we recorded a deficit in gross profit of ($585,782) for the three months and $481,902 for the six months ended June 30, 2012, compared to gross profit of $772,201 and $1,125,265 in the three and six months ended June 30, 2011.

Selling expense

For the three months ended June 30, 2012, selling expenses were $52,788 compared to $104,930 for the same period ended June 30, 2011, representing a decrease of 49.7 %. For the six months ended June 30, 2012, selling expenses were $109,686 compared to $175,203 for the same period ended June 30, 2011, representing a decrease of 37.4 %. This decrease was primarily due to our continued tighter controls over selling expenses in a weak market.

General and administrative expenses

We incurred general and administrative expenses of $738,513 and $1,426,533 for the three and six months ended June 30, 2012, compared to $676,488 and $1,577,268 in the same period of 2011, representing a increase of 9.2% for the three month ended and a decrease of 9.6% for the six months ended. Included in the general and administrative expenses was the amortization of stock based compensation and stock issued for services totaling $270,611 and $321,728 in the six months ended June 30, 2012 and 2011, respectively. The decrease in our general and administrative expenses was primarily due to tighter budget controls.

Research and development expenses

For the three months ended June 30, 2012, we incurred research and development expenses of $379,355, compared to $259,762 for the three months ended June 30, 2011. This represents an increase of 46.0%. For the six months ended June 30, 2012, we incurred research and development expenses of $534,925, compared to $290,572 for the six months ended June 30, 2011. This represents an increase of 84.1%. The increase in the expenses was due to our increased effort on research and development for several new products.

Operating loss

Our operating loss for the three months ended June 30, 2012 was $1,756,438, which was 553.0% greater than our operating loss for the three months ended June 30, 2011. Our operating loss for the six months ended June 30, 2012 was $2,553,046, which was 178.2% worse than our operating loss for the six months ended June 30, 2011.

Other income (expense)

In 2009, we entered into a joint venture agreement, pursuant to which we acquired a 35% interest for the contribution of certain assets with a fair value of RMB49,980,000 (approximately $7.3 million) and debt of RMB37,170,000 (approximately $5.4 million). Accounting standards require that we report a gain on the difference between the initial cost of the investment and our proportionate share of the fair value of the Joint Venture's net equity. Accordingly, we recorded a gain of $2,040,651 during the three and six months ended June 30, 2012.

During the three and six months ended June 30, 2012, the operations of the Joint Venture resulted in net losses of $189,003 and 499,280, respectively. Because we own 35% of the equity in the Joint Venture and account for that investment on the equity method, we recorded Equity in Loss of Joint Venture of $66,151 and $174,748 for the three and six months ended June 30, 2012. During the three and six months ended June 30, 2011, our equitable share of the Joint Venture's losses totaled $135,750 and $247,593, respectively.

In addition, during the three and six months ended June 30, 2012 we recorded net interest expense of $114,321 and $253,216, respectively. By comparison, during the three months ended June 30, 2011 we recorded net interest expense of $55,368. During the six months ended June 30, 2011 we recorded net interest income of $687,802 due to the classification as interest income of a portion of a debt settlement that we entered into in the first quarter of 2011 with our largest shareholder.

Net income/loss

We recorded a net loss of $1,043,289 for the six months ended June 30, 2012, which was 197% greater than the net loss of $351,791 recorded in the same period of 2011. During the three months ended June 30, 2012 we recorded net income of 811, compared to a net loss of $431,385. Our results in both the three and six month periods ended June 30, 2012 were skewed to the positive by the gain of $2,040,651 booked for the investment in joint venture in the quarter ended June 30, 2012. Details of the nature of the gain were described in footnote 5 of the financial statements.

Liquidity and Capital Resources

Net cash (used in) provided by operating activities.

Our operating activities during the six months ended June 30, 2012 used $2,682,319 in cash. The use of cash exceeded our net loss of $1,043,289 primarily because our net loss was reduced by the non-cash gain of $2,040,651 that we recorded as a result of our investment in the Joint Venture. In addition, during the period we increased our prepaid expenses by $767,814 in order to secure favorable relationships with our vendors. During the six months ended June 30, 2011 our operations yielded $1,896,830 in cash, despite a net loss of $351,791, as we reduced our inventory reserve by $2,334,284.

Net cash (used in) investing activities.

Net cash used in investing activities for the six months ended June 30, 2012 and 2011was $87,815 and $91,236, respectively, which resulted from the purchase of property and equipment.

Net cash (used in)/provided by financing activities.

We funded our operations during the six months ended June 30, 2012 by taking short-term loans totaling $2,855,126. In contrast, during the six months ended June 30, 2011, when our operations provided us cash, we paid $380,069 to reduce our outstanding short-term bank loans and $1,619,527 to reduce loan from shareholders.

The Company believes that its cash flows generated internally may not be sufficient to sustain operations and repay short term bank loans for the next twelve months. Therefore, from time to time, the Company may require extra funding through short term borrowing from PRC banks or other financing activities.

Working capital

The Company has a working capital deficit of $4,637,639 at June 30, 2012. This represented an atrophy of $2,235,091 since December 31, 2011. The primary reason for the atrophy of working capital was the $1,043,289 loss that we incurred during six months ended June 30, 2012, which we funded by taking short-term loans.

Contractual obligations

The following table describes our contractual commitments and obligations as of June 30, 2012:

Contractual Obligations	Payments due by Period (in $) Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
Short term loan	$ 6,900,570	$ 6,900,570	$ -	$ -	$ -
Loans from shareholder related party	$ 211,221	$ 211,221	$ -	$ -	$ -

Off-Balance Sheet Transactions

We have no material off-balance sheet transactions.

Impact of Recent Currency Exchange Rate Increase

We use the U.S. dollar as the reporting currency for our financial statements. Our operations are conducted through our PRC operating subsidiary, Sichuan Apollo, and our functional currency is the RMB. On July 21, 2005, the PRC government changed its policy of pegging the value of the RMB to the U.S. dollar and, as a result, the RMB has appreciated against the U.S. dollar by approximately 8.26% from 1:8.27 on July 21, 2005 to 1:6.6023 on December 31, 2010 and 1:6.30559 on December 31, 2011. In converting our RMB income statement amounts into U.S. dollars we used the following RMB/$ exchange rates: 6.3027 and 6.5383 for the six months ended June 30, 2012 and 2011 respectively. There is no guarantee that we will benefit from the exchange rate in the future and our operations may suffer if a less favorable exchange rate develops.

Future Capital Expenditures

On April 10, 2009, we signed the VIE Agreements to acquire the exploration rights of the Dashuigou area and the mining rights of the Majiahou mine. We expect to invest in exploration, mining equipment, and refinery facility in the future so that we can source tellurium internally. Additional capital for this objective may be required that is in excess of our current resources, requiring us to raise additional capital through additional equity offerings or secured or unsecured debt financing. The availability of additional capital resources will depend on prevailing market conditions, interest rates, and our existing material financial position and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of the end of the period covered by this report. That evaluation disclosed that the Company has material defects in its disclosure controls and procedures. Specifically management determined that there is a lack of expertise in U.S. GAAP among the Company's management personnel. They also determined that the size of the Company's accounting staff and low number of supervisory personnel prevented an appropriate segregation of accounting functions. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that were not effective as of June 30, 2012.

(b) Changes in Internal Controls

There were no changes in our internal control over financial reporting during the three months ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

In addition to other information set forth in this report, you should carefully consider the "Risk Factors" discussed in our Annual Report on Form 10-K filed on May 16, 2012, for our 2011 fiscal year. There have been no material changes to the "Risk Factors" previously disclosed in our Annual Report on Form 10-K.

ITEM 6. EXHIBITS

31.1	Rule 13a-14(a) Certification – CEO
31.2	Rule 13a-14(a) Certification – CFO
32	Rule 13a-14(b) Certification
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 Labels Linkbase Document*
101 PRE	XBRL Presentation Linkbase Document*

* The XBRL related information in Exhibit 101 shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

SIGNATURES

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

Apollo Solar Energy, Inc.

Date: August 14, 2012	By: /s/ Jingong Pan
	Jingong Pan Chief Executive Officer
Date: August 14, 2012	By: /s/ Hui Hua

Hui Hua
Chief Financial
Officer