

APOLLO SOLAR ENERGY, INC.  
Form 10-Q  
December 14, 2011

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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 September 30, 2011

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  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

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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 acceleratedo Accelerated filer o  
filer  
Non-acceleratedo Smaller reporting y  
filer 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 Act). Yes o No y

There were 51,655,961 shares of common stock issued and 49,237,038 shares outstanding as of June 30, 2011.

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APOLLO SOLAR ENERGY, INC.

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APOLLO SOLAR ENERGY, INC.  
CONSOLIDATED BALANCE SHEETS  
(In US Dollars)

	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 639,399	\$ 2,676,176
Account receivable net of allowance for doubtful accounts \$5,908 and \$3,465, respectively	527,522	294,214
Inventories	3,877,685	6,809,700
Due from Related parties	-	4,412,629
Deferred tax assets	248,350	
Prepaid expenses and other current assets	2,076,183	799,359
Total current assets	7,369,139	14,992,078
Property, machinery and mining assets, net	17,537,167	21,081,705
Asset held for sale	1,136,220	1,098,700
Non-marketable investment	54,822	53,012
Investment in joint venture	4,202,266	587,504
	22,930,475	22,820,921
Total assets	\$ 30,299,614	\$ 37,812,999

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Short-term loan	\$ 4,000,451	\$ 5,002,802
Account payable - trade	182,904	375,520
- construction vendors	1,743,693	2,844,102
Accrued expenses and other current liabilities	1,661,388	1,098,178
Deferred tax liabilities	-	25,329
Due to shareholders	209,587	1,814,260
Total current liabilities	7,798,023	11,160,191
Shareholders' equity		
Preferred stock, \$.001 par value, 25,000,000 shares authorized, 0 shares issued and outstanding at September 30, 2011 and December 31, 2010		
Common stock, \$.001 par value, 100,000,000 shares authorized, 51,655,961 shares issued and 49,237,038 shares outstanding at September 30, 2011 and 51,655,961 issued and outstanding at December 31, 2010	51,656	51,656
Additional paid-in capital	32,191,989	31,709,395
Treasury stock, 2,418,923 shares at cost	(5,273,253)	
Accumulated deficit	(7,274,272)	(7,128,838)
Accumulated other comprehensive income	2,805,471	2,020,595
Total shareholders' equity	22,501,591	26,652,808

Total liabilities and shareholders' equity	\$ 30,299,614	\$ 37,812,999
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APOLLO SOLAR ENERGY, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME (LOSS)  
(Unaudited)  
(In US Dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Sales	\$2,245,534	\$3,582,735	\$8,968,872	\$6,158,700
Cost of sales	(1,920,272 )	(2,577,786 )	(7,518,345 )	(4,675,245 )
Gross profit	325,262	1,004,949	1,450,527	1,483,455
<b>Operating Expenses</b>				
General and administrative expenses	835,272	862,246	2,412,540	2,785,182
Selling expenses	71,805	73,737	247,008	190,074
Research and development expenses	84,181	314,098	374,753	667,208
Total Operating Expenses	991,258	1,250,081	3,034,301	3,642,464
Operating Loss	(665,996 )	(245,132 )	(1,583,774 )	(2,159,009 )
Interest income (expenses)	(56,946 )	(68,356 )	630,851	(251,792 )
Loss on sale of assets	(132,398 )		(132,398 )	
Gain on investment in Joint Venture	1,205,110		1,205,110	
Loss in equity of Joint Venture	(141,078 )	(223,025 )	(388,666 )	(223,025 )
Income (loss) before income tax	208,692	(536,513 )	(268,877 )	(2,633,826 )
Income tax expense (credit)	2,335	-	(123,443 )	-
Net income (loss)	206,357	(536,513 )	(145,434 )	(2,633,826 )
<b>Other Comprehensive Income (Loss)</b>				
Foreign Currency Translation Adjustment	285,338	384,489	784,876	518,286
Comprehensive income (loss)	\$491,696	\$(152,024 )	\$639,442	\$(2,115,540 )
<b>Basic and Diluted Loss per common share</b>				
Basic and diluted	\$(0.00 )	\$(0.01 )	\$(0.00 )	\$(0.06 )
<b>Weighted average common share outstanding</b>				
Basic and diluted	49,237,038	50,133,662	49,848,414	47,885,783

APOLLO SOLAR ENERGY, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(In US Dollars)

	Nine Months Ended September 30,	
	2011	2010
<b>Cash flows from operating activities</b>		
Net loss	\$ (145,434)	\$ (2,633,826)
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	482,594	490,810
Depreciation and amortization	730,076	688,820
Deferred tax assets	(273,679)	-
Other interest income	(837,359)	-
Loss in equity of Joint Venture	388,666	223,025
Gain from investment in Joint Venture	(1,205,110)	-
Loss on sale of assets	132,398	-
Changes in assets and liabilities:		
Account receivable	(219,396)	(350,994)
Inventories	3,109,783	1,472,889
Prepaid expenses and other current assets	(1,227,911)	(234,968)
Account payable-trade	(201,883)	164,451
Accounts payable - construction	(1,176,804)	(265,401)
Accrued expenses and other current liabilities	516,616	730,207
Net cash provided by operating activities	72,557	285,013
<b>Cash flows from investing activities</b>		
Non-marketable investment	-	(7,346)
Purchase of property and equipment	(291,980)	(1,346,208)
Proceeds from sale of assets	769,622	-
Net cash provided by (used in) investing activities	477,642	(1,353,554)
<b>Cash flows from financing activities</b>		
Proceeds from (payment to) short-term loans	(1,152,886)	1,469,160
Proceeds from (payment to) shareholders	(1,637,789)	2,000,000
Advance from (payment to) shareholders	-	(20,477)
Advance from (payment to) related parties	237,413	(577,992)
Net cash provided by (used in) financing activities	(2,553,262)	2,870,691
E Effect of exchange rate changes on cash and cash equivalents	(33,714)	39,593
Net increase (decrease) in cash and cash equivalents	(2,036,777)	1,841,743
Cash and cash equivalents, beginning of period	2,676,176	507,776
Cash and cash equivalents, end of period	\$ 639,399	\$ 2,349,519

Supplemental disclosures of cash flow information:

Interest paid	\$ 198,880	\$ 174,826
Income taxes paid	\$ 12,009	\$ 92,263

Supplementary disclosure of non-cash financing activities:

Treasury stock acquired in exchange for loan to related parties	\$ 5,273,253	\$-
Assets transferred to Joint Venture	\$ 2,731,296	\$ -
Assets sold	\$ 942,955	\$-
Conversion of debt to common stock	\$ -	\$8,929,139



APOLLO SOLAR ENERGY, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010  
 (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, 2010 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 nine months ended September 30, 2011 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”).

The consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries, Sichuan Apollo, Diye, Da Du River, Ma Jia Gou and new subsidiary in Hefei. All significant inter-company transactions and balances among the Company and its subsidiaries are eliminated upon consolidation.

NOTE 2. INVENTORIES

Inventories consist of the following:

	As of	
	September 30, 2011	December 31, 2010
Raw Materials	\$ 584,753	\$ 1,646,217
Work-in-progress	1,188,350	2,261,022
Finished goods	2,104,582	2,902,461
<b>Total</b>	<b>\$ 3,877,685</b>	<b>\$ 6,809,700</b>

NOTE 3. PROPERTY, MACHINERY AND MINING ASSETS, NET

A summary of property and equipment and the estimate lives used in the computation of depreciation and amortization is as follows:

	As of		
	September 30, 2011	December 31, 2010	Life (years)
Buildings	\$ 13,265,572	\$ 14,199,056	40
Right to use land	1,772,804	4,131,884	50
Machinery and equipment	3,612,919	3,731,260	10
Office equipments	332,995	356,429	5
Vehicle	572,793	553,878	5-10
Mining	566,867	489,012	5-40
Construction in progress (1)	914,070	928,035	
Sub-total	21,038,020	24,389,554	
Less: Accumulated depreciation	(3,500,853 )	(3,307,849 )	
Total	\$ 17,537,167	\$ 21,081,705	

Depreciation expense for the nine months ended September 30, 2011 and 2010 was \$ 730,076 and \$688,820 respectively.

(1) Estimated costs to complete the construction in progress after September 30, 2011 are not anticipated to be material. Construction is expected to be completed by the end of 2011.

## NOTE 4. RELATED PARTIES TRANSACTIONS AND BALANCES

Due from related parties consists of the following:

	As of	
	September 30, 2011	December 31, 2010
Due from Xinju	\$ -	\$ 4,379,411
Due from Joint Venture	-	1,064
Due from shareholder	-	32,154
<b>Total</b>	<b>\$ -</b>	<b>\$ 4,412,629</b>

Xinju is a related party partially owned by a majority shareholder of Apollo, Renyi Hou, our former CEO. On March 10, 2011, Mr. Hou exchanged 2,418,923 shares of the Company's common stock in full settlement of approximately \$5.2 million due from Xinju. The amount due from Xinju was converted into 2,418,923 shares of the Company's common stock based on a fair market value of \$2.18 per share. The Joint Venture is a newly formed company in which Apollo holds a 35% of the equity interest. All the above loans are non-interest bearing and due on demand.

Due to related parties consists of notes due to shareholders with non-interest bearing and due on demand.

	As of	
	September 30, 2011	December 31, 2010
Due to shareholders	209,587	1,814,260
<b>Total</b>	<b>\$ 209,587</b>	<b>\$ 1,814,260</b>

## 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 September 30, 2011 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.

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 the JV's fair value of its net equity, which, if treated as a consolidated subsidiary would have resulted in negative goodwill to be recorded as a gain. During the nine months ended September 30, 2011, the Company contributed net assets with appraised value of approximately RMB 33,000,000 (approximately \$5 million) 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 approximately RMB 7,000,000 (approximately \$1.2 million) which is reported as income on the accompanying statement of operations for the nine months ended September 30, 2011. As of September 30, 2011, all of the capital contributions due to the JV have been made by Bengbu. Sichuan Apollo will report additional gains in subsequent periods when the additional contributions are made to the JV.



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

	For the nine month ended September 30, 2011	For the nine month ended September 30, 2010
Statement of operations		
Revenues	\$ 20,499	\$ 284,705
Cost of sales	18,884	285,459
Gross profit	1,615	(754 )
Operating Loss	(1,105,222 )	(637,216 )
Loss before income tax	\$ (1,105,222 )	\$ (637,216 )

	For the three month ended September 30, 2011	For the three month ended September 30, 2010
Statement of operations		
Revenues	\$ 17,358	\$ 284,705
Cost of sales	17,186	285,459
Gross profit	172	(754 )
Operating Loss	(397,812 )	(637,216 )
Loss before income tax	\$ (397,812 )	\$ (637,216 )

**NOTE 6. ACCRUED EXPENSES, TAXES AND OTHER CURRENT LIABILITIES**

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

	September 30, 2011	As of December 31, 2010
Accrued interest	\$ 810,265	\$ 782,515
Salaries and benefits	137,967	142,180
Value Added Taxes	349,228	11,402
Customer Deposit	43,868	0
Other accrued expenses	320,060	162,081
<b>Total</b>	<b>\$ 1,661,388</b>	<b>\$ 1,098,178</b>

## NOTE 7. SHORT-TERM LOAN

The short-term loans include the following:

	Balance at	
	September 30, 2011	December 31, 2010
a) Loan payable to Chengdu Xihang Gang Construction & Investment Co., Ltd due on demand without interest, collateralized by certain plant equipment of Sichuan Apollo	\$646,901	\$ 625,540
b) Loan payable to Bank of Communication, Chengdu branch due on February 8, 2011, with interest at 6.64% per annum, collateralized by the buildings and land use right of Diye. The loan was paid in full in January 2011.	-	302,924
c) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on August 24, 2011, with interest at 5.84% per annum, collateralized by the buildings of Sichuan Apollo, was paid in full in August 2011		757,312
d) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on September 7, 2011, with interest at 5.84% per annum, collateralize by the buildings of Sichuan Apollo, was paid in full in September, 2011		757,312
e) Loan payable to Merchant Bank, Wangjiang Road, Chengdu due on July 16, 2011, with interest at 6.97% per annum, collateralized by the buildings of Sichuan Apollo. This loan was paid in full on July 15, 2011.	-	1,060,237
f) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on January 7, 2012 with interest at 6.86% per annum, collateralized by the buildings of Sichuan Apollo	1,566,347	-
g) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on January 19, 2011, with interest at 5.84% per annum, collateralized by the buildings of Sichuan Apollo. This loan was paid in full in January 7, 2011		1,499,477
h) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on March 28, 2012 with interest at 6.73% per annum	1,566	-
i) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on August 25, 2012 with interest at 7.74% per annum	783,174	-
j) Loan payable to Bank of China, Xihanggang Branch, Chengdu due on September 19, 2012 with interest at 7.74% per annum	689,194	-
k) Loan payable to Bank of Communication, Chengdu branch due on September 12, 2012 with interest of 8.53% per annum	313,269	
<b>Total</b>	<b>\$4,000,451</b>	<b>\$ 5,002,802</b>



## NOTE 8. TAXES

## Corporation income tax

The Company is 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 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 comparison of income tax expense (credit) at the U.S. statutory rate of 35%, to the Company's effective tax is as follows:

	For the nine months ended	
	September 30, 2011	September 30, 2010
U.S. statutory rate a 35%	\$ (94,108)	\$ (921,839)
Tax rate difference between China and U.S.	83,369	284,780
Change in Valuation allowance	(51,788)	661,289
Other	(60,916)	(24,230)
Effective tax	\$ (123,443)	\$ -

The provisions for income taxes are summarized as follows:

	For the nine months ended	
	September 30, 2011	September 30, 2010
Current	\$ 150,238	\$ -
Deferred	(273,681)	-
Total	\$ (123,443)	\$ -

## 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.

## 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 September 30, 2011 and December 31, 2010, the Company did not accumulate any statutory reserve due to the accumulated deficit.





## NOTE 10. BUSINESS SEGMENTS

For the nine months ended September 30, 2011,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	\$ -	\$ 8,968,872	\$ -	\$ -	\$ 8,968,872
Operating loss	(614,467 )	(69,593 )	(210,322 )	(689,392)	(1,583,774 )
Depreciation and amortization	528,904	177,355	23,817	-	730,076
Capital expenditures	16,819	210,663	64,498	-	291,980
Total assets	17,658,413	9,406,260	3,023,590	211,351	30,299,614

For the three months ended September 30, 2011,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	\$-	\$2,245,534	\$-	\$-	\$2,245,534
Operating loss	(232,140 )	(200,514 )	(59,448 )	(173,894 )	(665,996 )
Depreciation and amortization	175,917	60,083	8,037	-	244,037
Capital expenditures	1,385	188,073	11,285	-	200,743
Total assets	17,658,413	9,406,260	3,023,590	211,351	30,299,614

For the nine months ended September 30, 2010,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
Revenue	\$ -	\$ 6,114,900	\$ 43,800	\$ -	\$ 6,158,700
Operating loss	(252,365)	(580,708)	(158,302)	(1,167,634)	(2,159,009)
Depreciation and amortization	438,893	229,028	20,899	-	688,820
Capital expenditures	1,036,008	76,663	233,537	-	1,346,208
Total assets	20,411,024	15,577,049	550,607	328,085	36,866,765

For the three months ended September 30, 2010,

	Manufacturing	Refining	Mining	Corporate & Others	Consolidated Total
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Revenue	\$	-	\$ 3,582,622	\$	113	\$	-	\$ 3,582,735
Operating loss		186,172	(97,911)		(75,153)		(258,240)	(245,132)
Depreciation and amortization		168,094	55,443		7,122			230,659
Capital expenditures		(18,471)	53,209		139,444			174,182
Total assets		20,411,024	15,577,049		550,607		328,085	36,866,765

NOTE 11. CONCENTRATIONS

For the nine months ended September 30, 2011, two major customers accounted for approximately 23% and 13% of total sales separately.

For the nine months ended September 30, 2010, two major customers accounted for approximately 55%, and 14% of total sales separately.

For the nine months ended September 30, 2011, 24% of sales were made to customers in North America and 75% of sales were made to customers in Asia.

For the nine months ended September 30, 2010, 64% of sales were made to customers in North America and 34% of sales were made to customers in Asia.

For the three months ended September 30, 2011, four major customers accounted for approximately 20%, 16%, 14% and 10% of total sales, respectively.

For the three months ended September 30, 2010, one major customer accounted for approximately 81% of total sales separately.

For the three months ended September 30, 2011, 18% of sales were made to customers in North America and 82% of sales were made to customers in Asia.

For the three months ended September 30, 2010, 90% of sales were made to customers in North America and 9% of sales were made to customers in Asia.

NOTE 12. FORMATION OF FULLY OWNED NEW SUBSIDIARY

On June 20, 2011, the Board of Directors approved the formation of a fully owned subsidiary in Hefei, Anhui province in China with registered capital of 10 million RMB (approximately \$1.5 million), to facilitate the solar panel installation project and the sale of solar panels the company purchased from EPV. On June 22, 2011, the capital inspection report was completed and the formation of the subsidiary was approved by local authorities on June 28, 2011, and the business license was obtained on the same date. As of the date this 10Q is filed, no sales of the Hefei subsidiary were made.

NOTE 13. 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 April 8, 2011, as amended by Amendment No. 1 to our Annual Report on Form 10-K, filed on May 2, 2011. 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 with 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 Dashiugou 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, between Sichuan Xinlong Tellurium Industry & Technique Co., Ltd., Sichuan Xinju Mineral Resources Development Co., Ltd., Renyi Hou, our former CEO and Ling Yong, our former CFO, which grants to our wholly-owned subsidiary a first option to purchase the Exploration 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 grants to our wholly-owned subsidiary the exclusive right to buy all of the output of the Exploration Business.
- Business Operation Agreement, between 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 Exploration 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 Exploration Business, on such terms as the parties shall agree from time to time.

Critical Accounting Policies, Estimates and Assumptions

During the nine months ended September 30, 2011, there were no changes made to our critical accounting policies and the use of estimates. For further information, please refer to “Critical Accounting Policies and Use of Estimates” included in Part II, Item 7 of our Annual Report on form 10-K for the year ended December 31, 2010 filed with the SEC on April 8, 2011, as amended by Amendment No. 1 to our Annual Report on Form 10-K, filed with the SEC on May 2, 2011.



## Results of Operations

Three Months Ended September 30, 2011 and compared to the three months ended September 30, 2010

### Sales

Sales for the three months ended September 30, 2011 were \$2,245,534, compared to the sales of \$3,582,735 in the same period in 2010, a decrease of \$1,337,201 or approximately 37.3%. Decrease in sale was primarily contributed to softening of demand. Another reason was the increase in cost of materials and the company's inability to pass on the cost to our customers. Shipping more product would have a negative impact on our profit margin. As such, the company has been in the process of re-negotiating the existing contracts with our customers with the goal to adjust pricing in the future.

### Cost of sales

Cost of sales for the three months ended September 30, 2011 was \$1,920,272, compared to the cost of sales of \$2,577,786 for the three months ended September 30, 2010 representing a decrease of \$657,514 or 25.5%. This decrease results primarily from the decrease in sales.

### Gross profit

Gross profit for the three months ended September 30, 2011 was \$325,262, compared to the gross profit of \$1,004,949 for the period ended September 30, 2010. The gross profit margin for the three months ended September 30, 2011 was 14.5% compared to 28.1% in the same period of 2010. The decrease in gross profit margin primarily resulted from the increase in the cost of materials and the Company's inability to pass on the cost to its customers.

### Selling expense

For the three months ended September 30, 2011, selling expenses were \$71,805 compared to \$73,737 for the same period ended September 30, 2010, representing a decrease of 2.6%. This decrease was primarily due to exchange rate changes in the quarter.

### General and administrative expenses

We incurred general and administrative expenses of \$835,272 for the three months ended September 30, 2011, compared to that of \$862,246 in the same period of 2010, representing a decrease of approximately 3.1%. For the three months ended September 30, 2011 and 2010, costs for stock based compensation and stock issued for services were \$160,866 and \$52,850, respectively. Excluding stock based compensation expense, we incurred other general and administrative expenses of \$674,406 for the three months ended September 30, 2011, as compared to expenses of \$809,396 for the same period of 2010, representing a decrease of 16.7%. Since the beginning of the year, management has committed effort to tighten cost control, the result of the past quarter shows that the effort has been successful.

### Research and development expenses

For the three months ended September 30, 2011, we incurred research and development expenses of \$84,181, compared to \$314,098 for the three months ended September 30, 2010. This represents a decrease of approximately 73.2%. The decrease in spending on research and development expenses was due to the fact that most of the research work on new materials was completed in the fiscal year of 2010.

### Net income/loss

For the three months ended September 30, 2011 we had a net income of \$206,357, compared to net loss of \$ 536,513 for the three months ended September 30, 2010. The primary reasons for the turning around from net loss to net income for the three months ended September 30, 2011 was the gain from investment in joint venture, which was \$1,205,110, which was significant enough to compensate the decrease in sales and the increase of general and administrative expenses.

Other

For the three months ended September 30, 2011 we incurred an equity loss of Joint Venture of \$141,078, interest expenses of \$56,946, loss on sale of asset of \$132,398 and provision for income taxes of \$2,335. For the three months ended September 30, 2010, we had equity in loss of Joint Venture of \$223,025 and no provision of income tax and interest expense of \$68,356.

Nine Months Ended September 30, 2011 and compared to the nine months ended September 30, 2010

#### Sales

Sales for the nine months ended September 30, 2011 were \$ 8,968,872, compared to the sales of \$6,158,700 in the same period in 2010, an increase of \$ 2,810,172 or approximately 45.6%. The increase was primarily due to increase in sales of Indium. Sales to the North American market increased significantly due to strong demand during the first six months.

#### Cost of sales

Cost of sales for the nine months ended September 30, 2011 was \$7,518,345, compared to the cost of sales of \$4,675,245 for the nine months ended September 30, 2010 representing an increase of \$2,843,100 or 60.8%. This increase results primarily from the increase in sales and was in line with the increase in sales.

#### Gross profit

Gross profit for the nine months ended September 30, 2011 was \$ 1,450,527, compared to the gross profit of \$1,483,455 for the period ended September 30, 2010. The gross profit margin for the nine months ended September 30, 2011 was 16.17% compared to 24.09% in the same period of 2010. The decrease in gross profit margin primarily resulted from higher costs of raw materials during the first quarter of 2011 and the company could not pass on to its customers. The company experienced gross profit margin improvement in the second quarter as the Company sourced raw materials from new channels and began to sell products with higher profit margin. However, the trend reversed in the third quarter and the company experienced the same difficulties as it had during the first quarter.

#### Selling expense

For the nine months ended September 30, 2011, selling expenses were \$247,008 compared to \$190,074 for the same period ended September 30, 2010, representing an increase of approximately 30.0%. This increase was primarily due increase of sales and our effort to explore and develop new markets.

#### General and administrative expenses

We incurred general and administrative expenses of \$2,412,540 for the nine months ended September 30, 2011, compared to that of \$2,785,182 in the same period of 2010, representing a decrease of approximately 13.4%. For the nine months ended September 30, 2011 and 2010, costs for stock based compensation and stock issued for services were \$482,594 and \$490,810 respectively. Excluding stock based compensation expense, we incurred other general and administrative expenses of \$1,929,946 for the nine months ended September 30, 2011, as compared to expenses of \$2,294,372 for the same period of 2010, representing a decrease of 15.9% which was primarily due to effective budget controls.

#### Research and development expenses

For the nine months ended September 30, 2011, we incurred research and development expenses of \$374,753, compared to \$667,208 for the nine months ended September 30, 2010. This represents a decrease of approximately 43.8%. The decrease in spending on research and development expenses was due to the fact that most of the research work on new materials was completed in the fiscal year of 2010.

#### Net income/loss

For the nine months ended September 30, 2011 we had a net loss of \$145,434, compared to net loss of \$2,633,826 for the nine months ended September 30, 2010. The primary reasons for the decrease in net loss for the six months ended September 30, 2011 was increase in sales and the reduction of general and administrative expenses plus interest income of prior year's loan to related parties, and a gain from investment in joint venture of \$1,205,110.

## Other

For the nine months ended September 30, 2011 we incurred an equity loss of Joint Venture of \$388,671, interest income of \$837,359, net of interest expense of \$206,503, loss on sale of asset of \$132,398 and provision for income taxes credit of \$123,443. For the nine months ended September 30, 2010, we had loss of equity in Joint Venture of \$223,025 and no provision for income tax and interest expense of \$251,792.

## Liquidity and Capital Resources

Net cash provided by operating activities.

Net cash provided by operating activities for the nine months ended September 30, 2011 was \$72,557 compared to net cash provided of \$258,013 in the same period in 2010. Cash provided by operating activities was accounted for by an increase in accounts receivable of \$219,396, a decrease in inventory of \$ 3,109,783, an increase in prepaid expenses of \$1,227,911, a decrease in the trade payable of \$201,883, and a decrease in the account payable- construction of \$1,176,804, and an increase in accrued expenses of \$516,616.

For the nine months ended September 30, 2010, cash provided by operating activities was contributed to an increase in accounts receivable of \$350,994, a decrease in inventory \$1,472,889, an increase in prepaid expenses of \$234,968, an increase in trade payable of \$164,451, a decrease in account payable- construction of \$265,401, and an increase in accrued expenses of \$730,207.

Net cash provided by (used in) investing activities.

Net cash provided by investing activities for the nine months ended September 30, 2011 was \$477,642 and cash used in investing activities for the same period in 2010 was \$1,353,554. Cash was generated for the nine months ended September 2011 which primarily resulted from the proceeds from sale of assets and less capital expenditure on the purchase of property and equipment.

Net cash used in investing activities for the nine months ended September 30, 2010 was \$1,353,554. For the nine months ended September 30, 2010, the cash used in investing activities primarily consisted of the purchase of property and equipment of \$1,346,208.

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

Net cash used in financing activities for the nine months ended September 30, 2011 was \$2,553,262, representing a payment to shareholder of \$1,673,789, advance from a related party of \$237,413 and payment with respect to a short-term loan of \$1,152,886. Net cash provided by financing activities for the nine months ended September 30, 2010 was \$2,870,691, consisting of \$1,469,160 cash inflow from short-term bank loans, \$2,000,000 net cash inflow from shareholders' loans and payment to related party of \$577,992, and a payment to a shareholder of \$20,477.

As of September 30, 2011, the company had a balance of cash and cash equivalent of \$639,399, compared to that of \$2,349,519 at the end of the third quarter in 2010.

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 if needed in the near future.

#### FORMATION OF FULLY OWNED NEW SUBSIDIARY

On June 20, 2011, the Board of Directors approved the formation of a fully owned subsidiary in Hefei, Anhui province with registered capital of 10 million RMB (approximately \$1.5 million), to facilitate the solar panel installation project and the sale of solar panels the company purchased from EPV. On June 22, 2011, the capital inspection report was completed and the formation of the subsidiary was approved by local authorities on June 28, 2011, and the business license was obtained on the same date. As of the date this 10Q is filed, no sales of the Hefei subsidiary were made.

#### Contractual obligations

Our contractual commitments and obligations as of September 30, 2011 was \$4,000,451, all of which will be matured within 12 months.

#### Seasonality

Our business is not cyclical and does not have a clear pattern of seasonality.

#### 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 22.8%, from 1:8.27 on July 21, 2005 to 1:6.8270 on December 31, 2009, 1:6.6023 on December 31, 2010 and 1:6.3843 on September 30, 2011. In converting our RMB income statement amounts into U.S. dollars we used the following RMB/\$ exchange rates: 6.3483 and 6.8066 for the nine months ended September 30, 2011 and 2010 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

### Foreign Exchange Risk

We use the U.S. dollar as the reporting and functional currency for our financial statements. As we conduct our operations through our PRC subsidiary, the functional currency of our PRC subsidiary is RMB. Substantially all our revenue and related expenses, including cost of revenues and advertising expenses, are denominated and paid in RMB. Transactions in other currencies are recorded in RMB at the rates of exchange prevailing when the transactions occur. Monetary assets and liabilities denominated in other currencies are remeasured into RMB at rates of exchange in effect at the balance sheet dates. Exchange gains and losses are recorded in our statements of operations as other comprehensive income.

The value of RMB is subject to changes in China's governmental policies and to international economic and political developments. In January, 1994, the PRC government implemented a unitary managed floating rate system. Under this system, the People's Bank of China, or PBOC, began publishing a daily base exchange rate with reference primarily to the supply and demand of RMB against the U.S. dollar and other foreign currencies in the market during the previous day. Authorized banks and financial institutions are allowed to quote buy and sell rates for RMB within a specified band around the central bank's daily exchange rate. On July 21, 2005, PBOC announced an adjustment of the exchange rate of the U.S. dollar to RMB from 1:8.27 to 1:8.11 and modified the system by which the exchange rates are determined. This modification has resulted in an approximate 22% appreciation of the RMB against the U.S. dollar from July 21, 2005 to September 30, 2011. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in further fluctuation of the exchange rate of RMB against the U.S. dollar. As all of our net revenues are recorded in RMB, any future devaluation of RMB against the dollar could negatively impact our results of operations.

### Commodity Price Sensitivity

We are exposed to market risk in connection with our inventory balances, which are comprised primarily tellurium, cadmium, selenium, indium and metal powder made from rare base metals. Our inventories are stated at the lower of cost or market using the weighted average method. If there is a downward change in the market price of base metals, we are required to mark-down the value of our inventory and record a loss in our statement of income. We cannot predict the extent to which high raw material price levels will continue in the future. We do not have any long-term raw material purchase contracts.

#### 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. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

##### (b) Changes in Internal Controls

There were no changes in our internal control over financial reporting during the three months ended September 30, 2011 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 April 8, 2011, as amended by Amendment No. 1 to our Annual Report on Form 10-K, filed on May 2, 2011, for our 2010 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

## Index to Exhibits

The following exhibits are filed as a part of this Report.

Exhibit No	Exhibit Title	Filed Herewith	Incorporated by Reference		
			Form	Exhibit No.	File No. Filing Date
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			
101.ins	XBRL Instance	X			
101.xsd	XBRL Schema	X			
101.cal	XBRL Calculation	X			
101.def	XBRL Definition	X			
101.lab	XBRL Label	X			
101.pre	XBRL Presentation	X			

\* Management contract, or compensatory plan or arrangement.

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.

D a t e :By: /s/ Jingong Pan  
December 14,  
2011

Jingong Pan  
Chief Executive Officer

D a t e :By: /s/ Wilson W. Liu  
December 14,  
2011

Wilson W. Liu  
Chief Financial Officer