Recon Technology, Ltd
Form 10-K
January 31, 2012

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended June 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 001-34409

RECON TECHNOLOGY, LTD

(Exact name of registrant as specified in its charter)

Cayman Islands	Not Applicable
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

1902 Building C, King Long International Mansion

9 Fulin Road, Beijing 100107

People’s Republic of China

(Address of principal executive offices and zip code)

+86 (10) 8494 5799

(Registrant’s telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, $0.0185 par value per share	NASDAQ Capital Market

Securities registered under Section 12(g) of the Exchange Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes £ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes £ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K or any amendment to this Form 10-K. £

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

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

The aggregate market value of the ordinary shares, $0.0185 par value per share ("Shares"), of the registrant held by non-affiliates on December 31, 2010 was approximately $12,612,144, based on the closing sales price of $4.65 per share, as reported on the Nasdaq Capital Market, multiplied by the number of outstanding Shares held by non-affiliates on that date (2,712,289).

The Company is authorized to issue 25,000,000 Shares. As of the date of this report, the Company has issued and outstanding 3,951,811 Shares.

DOCUMENTS INCORPORATED BY REFERENCE

This Form 10-K incorporates the registration statement filed with the Commission on August 12, 2008, as amended (file no. 333-152964) (the “Registration Statement”), and prospectus filed pursuant to Rule 424(b)(3) of the Securities Act of 1933 (the “Securities Act”) on July 24, 2009 (the “IPO Prospectus”). The Registration Statement and IPO Prospectus are incorporated by reference into Parts I, II and III of this Form 10-K.

RECON TECHNOLOGY, LTD

FORM 10-K

INDEX

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS		iii
PART I		I-1
Item 1.	Business	I-1
Item 1A.	Risk Factors	I-11
Item 1B.	Unresolved Staff Comments	I-11
Item 2.	Properties	I-11
Item 3.	Legal Proceedings	I-11
Item 4.	(Removed and Reserved)	I-11
PART II		II-1
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	II-1
Item 6.	Selected Financial Data	II-2
Item 7.	Management’s Discussion and Analysis or Plan of Operation	II-2
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	II-12
Item 8.	Financial Statements and Supplementary Data	II-12
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	II-13
Item 9A.	Controls and Procedures	II-13
Item 9B.	Other Information	II-14
PART III		III-1
Item 10.	Directors, Executive Officers and Corporate Governance	III-1
Item 11.	Executive Compensation	III-5
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	III-6
Item 13.	Certain Relationships and Related Transactions, and Director Independence	III-7
Item 14.	Principal Accountant Fees and Services	III-9
Item 15.	Exhibits, Financial Statement Schedules	III-10

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made statements in this annual report that constitute forward-looking statements. Forward-looking statements involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as “anticipate,” “estimate,” “plan,” “project,” “continuing,” “ongoing,” “expect,” “we believe,” “we intend,” “may,” “should,” “could” and sim expressions. These statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances or achievements expressed or implied by the forward-looking statements.

Examples of forward-looking statements include:

- projections of revenue, earnings, capital structure and other financial items;
- statements of our plans and objectives;
- statements regarding the capabilities and capacities of our business operations;
- statements of expected future economic performance; and
- assumptions underlying statements regarding us or our business.

The ultimate correctness of these forward-looking statements depends upon a number of known and unknown risks and events. Many factors could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Consequently, you should not place undue reliance on these forward-looking statements.

The forward-looking statements speak only as of the date on which they are made, and, except as required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

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

PART I

Item 1. Business.

General

We are a provider of hardware, software, and on-site services to companies in the petroleum mining and extraction industry in China ("PRC"). We provide services designed to automate and enhance the extraction of petroleum. To this end, we control by contract the PRC companies of Beijing BHD Petroleum Technology Co., Ltd. ("BHD"), Nanjing Recon Technology Co., Ltd. ("Nanjing Recon") and Jining ENI Energy Technology Co., Ltd. ("ENI") (only through December 15, 2010) (collectively, the "Domestic Companies"). ENI was one of our contractually controlled affiliates until December 16, 2010, when we ceased to have the power to direct its activities following a change of ownership. As a result of such change, ENI ceased to be our VIE starting December 16, 2010.

We are the center of strategic management, financial control and human resources allocation for the Domestic Companies. Through our contractual relationships with the Domestic Companies, we provide equipment, tools and other hardware related to oilfield production and management, and develop and sell our own specialized industrial automation control and information solutions. However, we do not engage in the production of petroleum or petroleum products.

We believe that one of the most important advancements in China's petroleum industry has been the automation of significant segments of the exploration and extraction process. The Domestic Companies' and our automation products and services allow petroleum mining and extraction companies to reduce their labor requirements and improve the productivity of oilfields. The Domestic Companies' and our solutions allow our customers to locate productive oilfields more easily and accurately, improve control over the extraction process, increase oil yield efficiency in tertiary stage oil recovery, and improve the transportation of crude oil.

Market Background

China is the world's second-largest consumer of petroleum products, third-largest importer of petroleum and sixth-largest producer of petroleum. In the last twenty years, China's demand for oil has more than tripled, while its production of oil has only modestly increased. China became a net importer of petroleum in 1983, and, as a result, oil production in China has been aimed at meeting domestic requirements. The oil industry in China is dominated by three state-owned holding companies: China National Petroleum Corporation (CNPC), China Petroleum and Chemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC). Foreign companies have also recently become involved in China's petroleum industry; however, according to Chinese law, China's national oil companies may take a majority (or minority) stake in any commercial discovery. As a result, the number of major foreign

companies involved in the industry is relatively limited: Agip, Apache, BP, ChevronTexaco, ConocoPhillips, Eni, ExxonMobil, Husky Energy, Kerr-McGee, Mitsubishi, Royal Dutch Shell, Saudi Aramco, and Total.

In the past, China's petroleum companies mined for petroleum by leveraging its abundance of inexpensive labor, rather than focusing on new technologies. For example, a typical, traditional oilfield with an annual capacity of 1,000,000 tons would require between 10,000 and 20,000 laborers. By contrast, when Baker CAC products were employed to explore and automate Cainan Oil Field, a desert oilfield in Xinjiang, annual capacity for the field reached 1,500,000 tons. Moreover, only 400 employees were required to manage the oilfield. After the introduction of Baker CAC's products into China's petroleum industry, Chinese companies have also sought to provide automation solutions.

In the primary oil recovery stage, oil pressure in an oil reservoir may be high enough to force oil to the surface. Approximately 20% of oil may be harvested at this stage. The secondary oil recovery stage accounts for another 5% to 15% of oil recovery and involves such efforts as pumps to extract petroleum and the injection of water, natural gas, carbon dioxide or other gasses into the oil reservoir to force oil to the surface. Most oilfields in China have now entered into the tertiary stage of oil recovery, at which oil extraction becomes increasingly difficult and inefficient. Tertiary recovery generally focuses on decreasing oil viscosity to make extraction easier and accounts for between 5% and 15% of oil recovery. Our efforts in tertiary recovery focus on reducing water content in crude oil in order to make extraction more efficient.

Our Products

We currently provide products and services to oil and gas field companies, which focus on the development and production of oil and natural gas. Our products and services described below correlate to the numbered stages of the oilfield production system graphical expression shown below.

Our products and services include:

Equipment for Oil and Gas Production and Transportation

- High-Efficiency Heating Furnaces (as shown above by No. 6). Crude petroleum contains certain impurities that must be removed before the petroleum can be sold, including water and natural gas. To remove the impurities and to prevent solidification and blockage in transport pipes, companies employ heating furnaces. BHD researched, developed and implemented a new oilfield furnace that is advanced, highly automated, reliable, easily operable, safe and highly heat-efficient (90% efficiency).

- Burner (as shown above by No. 5). We serve as an agent for the Unigas Burner which is designed and manufactured by UNIGAS, a European burning equipment production company. The burner we provide has the following characteristics: high degree of automation; energy conservation; high turn-down ratio; high security and environmental safety.

- Separator (as shown above by No. 2 and No. 3). The test separator is the key measurement device for gas and oil in metering plants. Oil and gas mixture spray on the oil block cap after entering into the separator through the oil pipeline. The diffused oil falls along the pipe wall to the separator bottom and through the draw-off pipe. The gas rises due to its low density and changes the flow direction after concentrating by the separator umbrella. In the process, the small oil droplets in the gas adhere to the umbrella wall and fall along the wall of the pipe. The de-oiled gas enters the pipeline through the freeing pipe at the top of the separator for measurement.

Oil and Gas Development Tools and Equipment

- Packers of Fracturing. This utility model is used concertedly with the security joint, hydraulic anchor, and slide bushing of sand spray in the well. It is used for easy seat sealing and sand-up prevention. The utility model reduces desilting volume and prevents sand up which makes the deblocking processes easier to realize. The back flushing is sand-stick proof.

- Production Packer. According to different withdraw points, the production packer separates different oil layers, and protects the oil pipe from sand and permeability, so as to promote the recovery ratio.

- Water Injection Packer. The water injection packer injects water into different layers rather than injecting on a large scale; this can reduce cost and promote effectiveness.

Oil and Gas Production Increasing Techniques

- Fissure Shaper. This is our proprietary product that is used along with a perforating gun to effectively increase perforation depth by between 46% and 80%, shape stratum fissures, improve stratum diversion capability and, as a result, improve our ability to locate oilfields and increase the output of oil wells.

- Sand Prevention in Oil and Water Well. This technique processes additives that are resistant to elevated temperatures into “resin sand” which will be transported to the bottom of the well via carrying fluid. The “resin sand” goes through the borehole, pilling up and compacting at the borehole and oil vacancy layer. Then an artificial borehole wall is formed, functioning as a means of sand prevention. This sand prevention technique has been adapted to more than 100 wells, including heavy oil wells, light oil wells, water wells and gas wells, with a 100% success rate and a 98% effective rate.

- Water Locating and Plugging Technique. High water cut affects the normal production of oilfields. Previously, there was no sophisticated method for water locating and tubular column plugging in China. The mechanical water locating and tubular column plugging technique we have developed resolves the problem of high water cut wells. This technique conducts a self-sealing-test during multi-stage usage and is reliable to separate different production sets effectively. The water location switch forms a complete set by which the water locating and plugging can be finished in one trip. The tubular column is adaptable to several oil drilling methods and is available for water locating and plugging in second and third class layers.

- *Fracture Acidizing. We inject acid to layers under pressure which can form or expand fissures. The treatment process of the acid is defined as fracture acidizing. The technique is mainly adapted to oil and gas wells that are blocked up relatively deeply, or the ones in the low permeable zones.*

- Electronic Broken-down Service. This service resolves block-up and freezing problems by generating heat from the electric resistivity of the drive pipe and utilizing a loop tank composed of an oil pipe and a drive pipe. This technique saves energy and is environment friendly. It can increase the production of oilfields that are in the middle and later periods.

Automation System and Service

- Pumping Unit Controller. Refers to process “1” above. Functions as a monitor to the pumping unit, and also collects data for load, pressure, voltage, startup and shutdown control.

- RTU Used to Monitor Natural Gas Wells. Collects gas well pressure data.

- Wireless Dynamometer and Wireless Pressure Gauge. Refers to process “1” above. These products replace wired technology with cordless displacement sensor technology. They are easy to install and significantly reduce the working load associated with cable laying.

- Electric Multi-Way Valve for Oilfield Metering Station Flow Control. Refers to process “2” above. This multi-way valve is used before the test separator to replace the existing three valve manifolds. It facilitates the electronic

control of the connection of the oil lead pipeline with the separator.

- Natural Gas Flow Computer System. Flow computer system used in natural gas stations and gas distribution stations to measure flow.

- Recon SCADA Oilfield Monitor and Data Acquisition System. Recon SCADA is a system which applies to the oil well, measurement station, and the union station for supervision and data collection.

- EPC Service of Pipeline SCADA System. A service technique for pipeline monitoring and data acquisition after crude oil transmission.

- EPC Service of Oil and Gas Wells SCADA System. A service technique for monitoring and data acquisition of oil wells and natural gas wells.

- EPC Service of Oilfield Video SurveIllance and Control System. A video surveillance technique for controlling the oil and gas wellhead area and the measurement station area.

- Technique Service for “Digital Oilfield” Transformation. Includes engineering technique services such as oil and gas SCADA system, video surveillance and control system and communication systems.

ISO9000 Certification

We have received ISO9000 certifications for several of our processes. The International Organization for Standardization consists of a worldwide federation of national standards bodies for approximately 130 countries, and the ISO9000 certification represents an international consensus of these standards bodies, with the aim of creating global standards of product and service quality. We have received ISO9000 certification for the following:

- Nanjing Recon has received certification for the development and service of RSCADA.
- BHD has received certification for high efficiency heating furnaces, import burners, and manometer surrogate rendition and service.
- ENI has received certification for the distribution service of instruments, valves, transformation and transmission apparatus, electromechanical equipment, and a pipeline leak hunting system with sound wave for oilfields and oilfield assistant agents.

Customers

We operate our business by cooperating with oil companies and their subsidiaries, petroleum administration bureau and local service companies. Most actual control of our direct and indirect clients can be traced to Sinopec and CNPC, the two major Chinese state-owned companies responsible for on-shore petroleum mining and extraction. We have conducted automation projects for plants in three of China’s four highest producing oilfields, Daqing, Shengli and Xinjiang. We have undertaken the automation projects at the following locations, among others:

Sinopec

- Jiangsu Oil Field
- Shengli Oil Field
- The Northwest Division

- The Southwest Division
- Zhongyuan Oil Field
- Sichuan Oil Field
- Jianghan Oil Field

We provide products and services to Sinopec under a series of agreements, each of which is terminable without notice. We first began to provide services to Sinopec in 1998. Sinopec accounted for approximately 32.39% and 16.49% of our revenues in 2010 and 2011, respectively, and any termination of our business relationships with Sinopec would materially harm our operations.

CNPC

- Qinghai Oil Field
- Tuha Oil Field
- Daqing Oil Field
- Jidong Oil Field
- Sichuan Oil Field
- Xinjiang Oil Field

- Huabei Oil Field

- Jilin Oil Field

We provide products and services to CNPC under a series of agreements, each of which is terminable without notice. We first began to provide services to CNPC in 2000. CNPC accounted for approximately 48.79% and 60.20% of our revenues in the fiscal years ended June 30, 2010 and 2011, respectively, and any termination of our business relationships with CNPC would materially harm our operations.

Our Strengths

- Safety of products. The automation projects we have conducted have demonstrated that our products are reliable, safe and effective at automating the petroleum extraction process.

- Efficiency of technology. We believe our technology increases efficiency and profitability for petroleum companies by enabling them to monitor, manage and control petroleum extraction; increase the amount of petroleum extracted and reduce impurities in extracted petroleum.

- Ability to leverage our knowledge of Chinese business culture. Many of our competitors are based outside of China. As the Domestic Companies are based in China, we are in a unique position to emphasize Chinese culture and business knowledge to obtain new customers and new agreements with existing customers. We believe that many Chinese businesses, including state-owned companies like Sinopec and CNPC, would prefer to hire a Chinese company to assist in their business operations if a Chinese company exists with the ability to fulfill their needs on a timely and cost-efficient basis. In addition, our knowledge of Chinese culture allows us to anticipate and adapt to Chinese oilfield management methods. We provide our software solutions in Mandarin for the benefit of our Chinese customers, and all of our customer support is available from fluent personnel.

- Experienced, successful executive management team. Our executive management team has significant experience and success in the petroleum automation industry. They will be able to draw on their knowledge of the industry and their relationships in the industry.

- Ability to leverage China’s cost structure. As a Chinese company, we believe we can operate our business more cost-effectively because all of our employees, operations and assets are located in China, resulting in lower labor, development, manufacturing and rent costs than we believe we would incur if we also maintained operations abroad. We expect these costs savings will be reflected in lower costs to our customers for comparable products.

- Ownership of our intellectual property. Because we own our intellectual property, we are able to avoid licensing fees or contravening licensing agreements.

Our Strategies

Our goal is to help our customers improve their efficiency and profitability by providing them with software and hardware solutions and services to improve their ability to locate productive oil reservoirs, manage the oil extraction process, reduce extraction costs, and enhance recovery from extraction activities. Key elements of our strategies include:

- Increase our market share in China. We believe that as the Chinese economy and oil industry continue to develop, Chinese petroleum extraction automation companies will compete with international businesses at an increasing rate. Consequently, we believe we will have opportunities to take market share from foreign companies by developing positive business relationships in China's petroleum mining and extraction industry. We will also use strategic advertisements, predominantly in China's northeast and northwest, where China's major oilfields are located, to increase our brand awareness and market penetration. We will continue to develop new technologies designed to improve petroleum mining and extraction efficiency and profitability for our customers.

- Develop our own branded products and services and shift focus away from trading business. Our management believes in the importance of our own branded products and our services, in light of their higher profit margins and their long-term significance in establishing the status of our Company in the oil and gas industry. Moreover, the trading business relies on the major clients' in procurement policies toward agencies, any significant change of which could jeopardize our operating results. Our management therefore believes that in the long run we will need to focus our growth strategy in developing professional services for the oil and gas industry in China.

- Focus on higher-profit subsection of market. While we plan to continue to provide services to all of our clients, we believe that we may improve our profit margins by focusing a higher portion of our advertising and promotions at those sub-divisions of our industry that have traditionally held the highest profit margins.

- Offer services to foreign oilfields contracted by Chinese petroleum companies. As Sinopec and CNPC continue to invest in oilfields in other countries, we will focus on offering our services in these new locations based on our success in working with the companies in China.

- Seek opportunities with foreign companies in China. Even where oilfields in China are partially operated by foreign companies, a significant number of employees will be Chinese and will benefit from our Chinese-language services. We believe our hardware and software solutions would be beneficial to any petroleum company doing business in China and will continue to market to foreign companies entering the Chinese market.

- Provide services that generate high customer satisfaction levels. Chinese companies in our market are strongly influenced by formal and informal referrals. We believe that we have the opportunity to expand market share by providing high levels of customer satisfaction with our current customers, thereby fostering strong customer referrals to support sales activities.

Competition

We face competition from a variety of foreign and domestic companies involved in the petroleum mining automation industry. While we believe we effectively compete in our market, our competitors hold a substantial market share.

A few of our existing competitors, as well as a number of potential new competitors, have significantly greater financial, technical, marketing and other resources than we do, which could provide them with a significant competitive advantage over us. We cannot guarantee that we will be able to compete successfully against our current or future competitors in our industry or that competition will not have a material adverse effect on our business, operating results and financial condition.

Our primary domestic competitors include the following:

- Beijing Echo Technologies Development Co., Ltd. (“BET”). BET provides a combination of software and hardware products for industrial automatic control systems in the petroleum industry. BET currently engages in research and development of software and hardware applied to industrial automatic control systems, manufacturing and

installation of industrial automation instruments and integration of automatic control products.

- Beijing Golden-Time Petroleum Measurement Technology Co., Ltd. (“BGT”). BGT develops analysis software used in oilfields but does not yet, to our knowledge, produce a substantial amount of hardware products.

Our primary foreign competitors include the following:

- Schlumberger Limited (“Schlumberger”). Schlumberger is an oilfield services provider for oil and gas companies around the world. Schlumberger recently launched a family of multistage fracturing and completion services, which have integrated stimulation technologies.

- Baltur Technologie Per IL Clima (“Baltur”). Baltur designs advanced products for the high performance burner, boiler and air conditioning markets.

- Honeywell International, Inc. (“Honeywell”). Honeywell provides diversified products and services including aerospace products and services, control technologies for buildings, homes and industry, automotive products, turbochargers, and specialty materials.

- Emerson Process Management (“Emerson”). Emerson is a global supplier of products, services, and solutions that measure, analyze, control, automate, and improve process-related operations.

- Rockwell Automation, Inc. (“Rockwell”). Rockwell provides industrial automation power, control and information solutions to a wide range of industries. Rockwell provides both stand-alone, industrial components and enterprise-wide integrated systems.

Research and Development

We focus our research and development efforts on improving our development efficiency and the quality of our products and services. As of June 30, 2011, our research and development team consisted of 20 experienced engineers, developers and programmers. In addition, some of our support employees regularly participate in our research and development programs.

In the fiscal years ended June 30, 2010 and 2011, respectively, we spent ¥1,775,347 and ¥3,078,391 ($476,236), respectively, on research and development activities.

Intellectual Property

Our success and competitive position is dependent in part upon our ability to develop and maintain the proprietary aspect of our technology. The reverse engineering, unauthorized copying, or other misappropriation of our technology could enable third parties to benefit from our technology without paying for it. We rely on a combination of trademark, trade secret, copyright law and contractual restrictions to protect the proprietary aspects of the Domestic Companies' and our technology. We seek to protect the source code to the Domestic Companies' and our software, documentation and other written materials under trade secret and copyright laws. While we actively take steps to protect the Domestic Companies' and our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of the Domestic Companies' and our intellectual property. This is particularly the case in China where the laws may not protect our proprietary rights as fully as in the United States.

We license the Domestic Companies' and our software products under signed license agreements that impose restrictions on the licensee's ability to utilize the software and do not permit the re-sale, sublicense or other transfer of the software. Finally, we seek to avoid disclosure of the Domestic Companies' and our intellectual property by requiring employees and independent consultants to execute confidentiality agreements.

Although the Domestic Companies and we develop our software products, each is based upon middleware developed by third parties. We integrate this technology, licensed by our customers from third parties in our software products. If our customers are unable to continue to license any of this third party software, or if the third party licensors do not adequately maintain or update their products, we would face delays in the releases of our software until equivalent technology can be identified, licensed or developed, and integrated into our software products. These delays, if they occur, could harm our business, operating results and financial condition.

There has been a substantial amount of litigation in the software industry regarding intellectual property rights. It is possible that in the future third parties may claim that our current or potential future software solutions infringe their intellectual property. We expect that software product developers will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlap. In addition, we may find it necessary to initiate claims or litigation against third parties for infringement of our proprietary rights or to protect our trade secrets. Although the Domestic Companies and we may disclaim certain intellectual property representations to our customers, these disclaimers may not be sufficient to fully protect us against such claims. Any claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require the Domestic Companies and us to enter into royalty or license agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all, which could have a material adverse effect on our business, operating results and financial condition.

Our standard software license agreements contain an infringement indemnity clause under which we agree to indemnify and hold harmless our customers and business partners against liability and damages arising from claims of various copyright or other intellectual property infringement by the Domestic Companies' and our products. We have never lost an infringement claim and our costs to defend such lawsuits have been insignificant. Although it is possible that in the future third parties may claim that our current or potential future software solutions or we infringe on their intellectual property, we do not currently expect a significant impact on our business, operating results, or financial condition.

We market our products under the following trademarks which are registered with the PRC Trademark Bureau under the State Administration for Industry and Commerce. We currently own or have applied for the following trademarks:

1. Trademark of "Senior" valid from May 14, 2005 through May 13, 2015;

2. Trademark of “BHD” valid from November 7, 2003 through November 6, 2013;

3. We have submitted the trademark application of “Recon” on August 17, 2009. The application was accepted by the PRC Trademark Bureau and is currently under review. We anticipate the approval may be granted in the first half of 2012.

We currently own or have applied for the following 9 patents registered with the State Intellectual Property Office which are applied on our automated services products for the petroleum extraction industry:

1. Patent of oilfield wastewater degreasing treatment plant valid until May 15, 2013;

2. Patent of fracturing packer valid until August 5, 2018;

3. Patent of pressure phase transition furnace valid until June 3, 2019;

4. Patent of vacuum furnace phase transition valid until August 5, 2019;

5. Patent of heavy oil pipeline valid until June 17, 2015;

6. Patent of automatically adjusting negative pressure burner valid until July 22, 2019; and

7. Patent of wireless data instrument diagram valid until December 10, 2018;

8. We have submitted two patent applications (hot water furnace and multifunctional heating furnace) on August 8, 2011. The applications were accepted by the State Intellectual Property Office and are currently under review. We anticipate the approval may be granted in the first half of 2012.

We have registered the following software products with the State Intellectual Property Office:

1. Recon flow control computer monitoring system software was registered and published on February 8, 2008;

2. Recon SCADA field monitoring and data acquisition system software version 2 was published on August 18, 2003, and version 3 was registered and published on April 5, 2008.

Litigation

From time to time, we may become involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are currently not aware of any such pending or threatened legal proceedings, claims, regulatory inquiries or investigations that we believe will have a material adverse affect on our business, financial condition or operating results.

Environmental Matters

We have not incurred material expenses in connection with compliance with Chinese environmental laws and regulations. We do not anticipate expending any material amounts for such compliance purposes for the remainder of our current or succeeding fiscal year.

China's Intellectual Property Rights Enforcement System

In 1998, China established the State Intellectual Property Office ("SIPO") to coordinate China's intellectual property enforcement efforts. SIPO is responsible for granting and enforcing patents, as well as coordinating intellectual property rights related to copyrights and trademarks. Protection of intellectual property in China follows a two-track system. The first track is administrative in nature, whereby a holder of intellectual property rights files a complaint at a local administrative office. Determining which intellectual property agency can be confusing, as jurisdiction of intellectual property matters is diffused throughout a number of government agencies and offices, with each typically responsible for the protection afforded by one statute or one specific area of intellectual property-related law. The second track is a judicial track, whereby complaints are filed through the Chinese court system. Since 1993, China has maintained various intellectual property tribunals. The total volume of intellectual property related litigation, however, remains small.

Although there are differences in intellectual property rights between the United States and China, of most significance to the Company is the inexperience of China in connection with the development and protection of intellectual property rights. Similar to the United States, China has chosen to protect software under copyright law rather than trade secrets, patent or contract law. As such, we will attempt to protect our most significant intellectual property pursuant to Chinese laws that have only recently been adopted. Unlike the United States, which has lengthy case law related to the interpretation and applicability of intellectual property law, China has a less developed body of relevant intellectual property case law.

Regulation on Software Products

On March 1, 2009, the Ministry of Industry and Information Technology of China issued the Administrative Measures on Software Products, or the Software Measures, which became effective as of April 10, 2009, to strengthen the regulation of software products and to encourage the development of the Chinese software industry. Under the Software Measures, a software developer must have all software products imported into or sold in China tested by a testing organization supervised by the Ministry of Industry and Information Technology. The software industry authorities in provinces, autonomous regions, municipalities and cities with independent planning are in charge of the registration, report and management of software products. Software products can be registered for five years, and the registration is renewable upon expiration. Although Nanjing Recon's current software products were registered in 2008, there can be no guarantee that the registration will be renewed in 2013 or that the Domestic Companies' and our future products will be registered.

Regulation of Intellectual Property Rights

China has adopted legislation governing intellectual property rights, including trademarks and copyrights. China is a signatory to the main international conventions on intellectual property rights and became a member of the Agreement on Trade Related Aspects of Intellectual Property Rights upon its accession to the WTO in December 2001.

Copyright. China adopted its first copyright law in 1990. The National People's Congress amended the Copyright Law in 2001 to widen the scope of works and rights that are eligible for copyright protection. The amended Copyright Law extends copyright protection to software products, among others. In addition, there is a voluntary registration system administered by the China Copyright Protection Center. Unlike patent and trademark registration, copyrighted works do not require registration for protection. Protection is granted to individuals from countries belonging to the copyright international conventions or bilateral agreements of which China is a member. Nanjing Recon has two copyrights for software programs.

Trademark. The Chinese Trademark Law, adopted in 1982 and revised in 1993 and 2001, protects registered trademarks. The Trademark Office under the Chinese State Administration for Industry and Commerce handles trademark registrations and grants a term of ten years to registered trademarks. Trademark license agreements must be filed with the Trademark Office for record. China has a "first-to-register" system that requires no evidence of prior use or ownership. The Domestic Companies and we have registered a number of product names with the Trademark Office.

Regulations on Foreign Exchange

Foreign Currency Exchange. The principal regulations governing foreign currency exchange in China are the Foreign Exchange Administration Regulations (1996), as amended, and the Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996). Under these regulations, Renminbi are freely convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions, but not for most capital account items, such as direct investment, loan, repatriation of investment and investment in securities outside China, unless the prior approval of SAFE or its local counterparts is obtained. In addition, any loans to an operating subsidiary in China that is a foreign invested enterprise, cannot, in the aggregate, exceed the difference between its respective approved total investment amount and its respective approved registered capital amount. Furthermore, any foreign loan must be registered with SAFE or its local counterparts for the loan to be effective. Any increase in the amount of the total investment and registered capital must be approved by the PRC Ministry of Commerce or its local counterpart. We may not be able to obtain these government approvals or registrations on a timely basis, if at all, which could result in a delay in the process of making these loans.

The dividends paid by the subsidiary to its shareholder are deemed shareholder income and are taxable in China. Pursuant to the Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), foreign-invested enterprises in China may purchase or remit foreign exchange, subject to a cap approved by SAFE, for settlement of current account transactions without the approval of SAFE. Foreign exchange transactions under the capital account are still subject to limitations and require approvals from, or registration with, SAFE and other relevant PRC governmental authorities.

Regulation of Dividend Distribution. The principal regulations governing the distribution of dividends by foreign holding companies include the Foreign Investment Enterprise Law (1986), as amended, and the Administrative Rules under the Foreign Investment Enterprise Law (2001).

Under these regulations, foreign investment enterprises in China may pay dividends only out of their retained profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, foreign investment enterprises in China are required to allocate at least 10% of their respective retained profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends.

Notice 75. On October 21, 2005, SAFE issued Notice 75, which became effective as of November 1, 2005. According to Notice 75, prior registration with the local SAFE branch is required for PRC residents to establish or to control an offshore company for the purposes of financing that offshore company with assets or equity interests in an onshore enterprise located in the PRC. An amendment to registration or filing with the local SAFE branch by such PRC resident is also required for the injection of equity interests or assets of an onshore enterprise in the offshore company or overseas funds raised by such offshore company, or any other material change involving a change in the capital of the offshore company.

Moreover, Notice 75 applies retroactively. As a result, PRC residents who have established or acquired control of offshore companies that have made onshore investments in the PRC in the past are required to complete the relevant registration procedures with the local SAFE branch. Under the relevant rules, failure to comply with the registration procedures set forth in Notice 75 may result in restrictions being imposed on the foreign exchange activities of the relevant onshore company, including the increase of its registered capital, the payment of dividends and other distributions to its offshore parent or affiliate and capital inflow from the offshore entity, and may also subject relevant PRC residents to penalties under PRC foreign exchange administration regulations.

PRC residents who control the Company are required to register with SAFE in connection with their investments in us. Such individuals completed this registration in 2007, and 2008, as amended. If we use our equity interest to purchase the assets or equity interest of a PRC company owned by PRC residents in the future, such PRC residents will be subject to the registration procedures described in Notice 75.

Regulations on Foreign Investment in Automation Service Industry and Oil Exploration and Extraction Industry in PRC. In accordance with the Catalogue of Industries for Guiding Foreign Investment (Revised 2007), the oil and gas automation service industries are in the catalogue of permitted industries, and thus there are no restrictions on foreign investment in such industry. In addition the following industries are encouraged for foreign investment in China:

- Manufacturing of equipment for oil prospecting, well drilling, and centralized transportation: floating well drilling system and floating production system operating at a water depth over 500m, seabed oil extraction & centralized transportation equipment operating at a water depth over 600m, deep-water oil driller with winch power over 3000KW, top driving power over 850KW and drilling pump power over, land-based oil driller & desert-based oil driller for drilling wells deeper than 9000m, 80 ton or bigger reciprocating piston compressor for use in oil refineries with a capacity of 10 million tons/year, CNC oil well measuring instrument, and oil drilling mud-hole equipment.

- Exploration and exploitation of oil and natural gas with venture capital (limited to equity joint ventures and cooperative joint ventures);

- Development and application of new technologies that increase the recovery ratio of crude oil (limited to equity joint ventures and cooperative joint ventures);

- Development and application of new oil exploration and exploitation technologies such as geophysical exploration, drilling, well logging, and downhole operation, etc. (limited to cooperative joint ventures); and

- Exploration and development of unconventional oil resources such as oil shale, oil sands, heavy oil, and excess oil (limited to cooperative joint ventures).

Employees

As of June 30, 2011, we had 77 employees, all of whom were based in China. Of the total, 8 were in management, 20 were in technical support and research and development, 22 were engaged in sales and marketing, 12 were in financial affairs, and 15 were in administration and procurement. We believe that our relations with our employees are good. We have never had a work stoppage, and our employees are not subject to a collective bargaining agreement.

Insurance

We do not have any business interruption, litigation or natural disaster insurance coverage for our operations in China. Insurance companies in China offer limited business insurance products. While business interruption insurance is available to a limited extent in China, we have determined that the risks of interruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. Therefore, we are subject to business and product liability exposure. Business or product liability claims or potential regulatory actions could materially and adversely affect our business and financial condition.

We do, however, pay certain required insurance amounts in connection with our employees' wages. The amount and types of insurance we must provide under Chinese and local requirements vary by the location of each of the Domestic Companies. The following table summarizes the types of insurance paid for each of the Domestic Companies:

Nanjing Recon

Housing Fund

Pension

Unemployment Insurance

Medical Insurance

Occupational Injury Insurance

Maternity Insurance

BHD

Pension

Unemployment Insurance

Medical Insurance

Occupational Injury Insurance

ENI (through December 15, 2010)

Pension

Unemployment Insurance

Medical Insurance

Occupational Injury Insurance

Maternity Insurance

Item 1A. Risk Factors.

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

Item 1B. Unresolved Staff Comments.

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

Item 2. Properties.

We currently operate in three facilities throughout China. Our headquarters are located in Beijing.

Office	Address	Rental Term	Space
Headquarters	Room 1902, Building C King Long International Mansion, Chaoyang District Beijing, PRC	July 1, 2011 to June 30, 2012	220 square meters
Nanjing Recon	Yongfeng Mansion, 14th Floor No. 123 Jiqing Road Nanjing City, PRC	July 10, 2011 to July 9, 2012	440 square meters

BHD	18th Floor, Building C King Long International Mansion, Chaoyang District Beijing, PRC	January 1, 2011 to December 31, 2012	450 square meters

Item 3. Legal Proceedings.

From time to time, we may become involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are currently not aware of any such pending or threatened legal proceedings, claims, regulatory inquires or investigations that we believe will have a material adverse affect on our business, financial condition or operating results.

Item 4. (Removed and Reserved)

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

(a) Market for Our Ordinary Shares

We completed our initial public offering on July 29, 2009. The following table sets forth the quarterly high and low sale prices for our ordinary shares as reported on the NASDAQ Capital Market.

Fiscal 2011

	High	**Low**
First Quarter Ended September 30, 2010	$6.10	$4.35
Second Quarter Ended December 31, 2010	$6.49	$3.96
Third Quarter Ended March 31, 2011	$4.96	$2.98
Fourth Quarter Ended June 30, 2011	$4.50	$0.88
Year Ended June 30, 2011	$6.49	$0.88

As of June 30, 2011, there were approximately six holders of record of our ordinary shares. This excludes our ordinary shares owned by shareholders holding ordinary shares under nominee security position listings. On June 30, 2011, the last sales price of our ordinary shares as reported on the NASDAQ Capital Market was $2.39 per ordinary share.

Dividend Policy

We have never declared or paid any cash dividends on our ordinary shares. We anticipate that we will retain any earnings to support operations and to finance the growth and development of our business. Therefore, we do not expect to pay cash dividends in the foreseeable future. Any future determination relating to our dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions and future prospects and other factors the Board of Directors may deem relevant.

Because we are a holding company with no operations of our own and all of our operations are conducted through our Chinese subsidiary, our ability to pay dividends and to finance any debt that we may incur is dependent upon dividends and other distributions paid. In addition, Chinese legal restrictions permit payment of dividends to us by our Chinese subsidiary only out of its accumulated net profit, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, our subsidiary is required to set aside a portion (at least 10%) of its after-tax net income (after discharging all cumulated loss), if any, each year for compulsory statutory reserve until the amount of the reserve reaches 50% of our subsidiaries' registered capital. These funds may be distributed to shareholders at the time of its wind up. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Holding Company Structure."

Payments of dividends by our subsidiary in China to the Company are also subject to restrictions including primarily the restriction that foreign invested enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents. There are no such similar foreign exchange restrictions in the Cayman Islands.

(b) The section entitled "Use of Proceeds" from our registration statement filed on August 12, 2008, as amended (the "Registration Statement") is incorporated herein by reference. The effective date of the Registration Statement is July 22, 2009, and the Commission file number assigned to the Registration Statement is 333-152964. The Registration Statement registers the offering of up to 1,700,000 ordinary shares (subject to amendment in accordance with the Securities Act of 1933 and the rules and regulations promulgated thereunder) (the "Offering"). As of June 30, 2011, the Company has spent proceeds from the Offering in accordance with the following chart:

Description of Use	Proposed Expenditure Amount	Actual Expenditures through June 30, 2011
Product Research and development	$ 1,273,024	$ 476,236
Acquisition and business development in oil-field industry in China and globally	4,073,675	4,200,000
Sarbanes-Oxley compliance	424,341	0
Fixed asset purchases	442,341	0
Employee training	169,736	6,639
General working capital	2,121,706	1,449,046
Due from former VIE	—	2,600,000
Total	$ 8,504,823	$ 8,731,921

II-1

(c) None.

Item 6. Selected Financial Data.

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

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

Overview

We are a company with limited liability incorporated in 2007 under the laws of the Cayman Islands. Headquartered in Beijing, we provide products and services to oil and gas companies and their affiliates through our Domestic Companies. As the company contractually controlling the Domestic Companies, we are the center of strategic management, financial control and human resources allocation.

Our business is mainly focused on the upstream sectors of the oil and gas industry. We derive our revenues from the sales and provision of (1) hardware products, (2) software products, and (3) services. Our products and services involve most of the key procedures of the extraction and production of oil and gas, and include automation systems, equipment, tools and on-site technical services.

Our VIEs provide the oil and gas industry with equipment, production technologies, automation and services to enhance our customers' efficiency.

• Nanjing Recon: Nanjing Recon is a high-tech company that specializes in automation services for oilfield companies. It mainly focuses on providing automation solutions to the oil exploration industry, including monitoring wells, automatic metering to the joint station production, process monitor, and a variety of oilfield equipment and control systems.

• BHD: BHD is a high-tech company that specializes in transportation equipment and stimulation productions and services. Possessing proprietary patents and substantial industry experience, BHD has built up stable and strong working relationships with the major oilfields in China.

Business Outlook

The oilfield engineering and technical service industry is generally divided into five sections: (1) exploration, (2) drilling and completion, (3) testing and logging, (4) production and (5) oilfield construction. Thus far our businesses have only focused on production. Our management believes it is time to expand our business, leverage our core expertise, and develop new products and services. Management anticipates opportunities both in new markets and our existing markets. We believe that many existing oil wells and oilfields are in need of renewal and improvement on their current equipment to maintain production. Accordingly, products and services such as ours will be in demand as new oil and gas fields are developed and improved. In the next three years, we will focus on the following areas.

Measuring Equipment and Service. Our priority is the development of our well, pipeline and oilfield Supervisory Control and Data Acquisition (“SCADA”) engineering project service, oilfield video surveillance and control system, and reforming technical support service. According to industry estimates, the potential market for our wireless indicator and remote monitoring system, SCADA, is approximately RMB 5 billion.

Gathering and Transferring Equipment. (1) Furnace. We estimate total market demand in China for furnaces like ours at about 2,000 units per year, of which 500 are expected to come from new wells and 1,500 are expected to come from reconstruction of old wells. The potential market is estimated at ¥800 million (approximately $121 million) based on an average price of ¥400,000 (approximately $60,498) per furnace. (2) Oil/water separator. We estimate the total market demand in China at about 800 units per year, of which 300 are expected to come from new wells and 500 are expected to come from reconstruction of old wells. The potential market is about ¥400 million (approximately $60 million) based on an average price of ¥500,000 (approximately $75,622). (3) Burner. We estimate total market demand in China at about 5,000 units per year, of which 1,000 are expected to come from new wells and 4,000 are expected to come from reconstruction of old wells. The potential market is about ¥300 million (approximately $45 million) based on an average unit price of ¥60,000 (approximately $9,075).

New Business. Along with the opening of the oilfield service market to private companies, we are starting to establish our own service team equipped with specialized equipment and experienced staff. We expect the new business to start generating revenues during the quarter ended December 31, 2011.

Recent Industry Developments

Our trading business was harmed by our clients' policy in the last year. Beginning in 2010, big state-owned Chinese oil companies began implementing significant adjustments to their operating strategies. The following strategic initiatives implemented by the large Chinese oil companies have had a significant impact on our business and operations:

- Development of strategic suppliers, and enhancement of direct cooperation with well-known domestic and international companies;

- Enhanced cooperation with qualified domestic manufacturers of equipment and suppliers of technology and services; and

- Increased focus on exploration and exploitation, and introduction of products and techniques through outsourcing with professional private enterprises in the remaining sectors of the industry chain, especially the development and production sectors.

These polices aim to establish stable long-term supply channels and secure better prices and higher quality services. They also help speed up the nationalization of major equipment and critical materials, and the implementation of new products and services.

Accordingly, our businesses were affected in the following ways:

• Previously, approximately one-third of our revenue came from our business with Sinopec by acting as an agent. This business was primarily conducted by our contractually controlled affiliate, ENI. We received orders mainly by tendering. Then we would need to use our own funds to purchase specified equipment and we get paid after the contract period (usually 1 year). With the previously higher barrier to entry in this market, we were able to make considerable profits. However, our business has suffered as a result of big Chinese oil companies' policy adjustments. Especially for Sinopec, for the year 2010, its procurement from strategic suppliers rose rapidly to 60%, and this ratio is expected to be over 80% by the end of China's economic development Twelfth Five Year Plan. We do not manufacture the equipment ourselves and cannot meet the standards for being a strategic supplier to the big oil companies. As a result of such adjustments, our business operated by ENI has experienced difficulty winning larger projects with higher gross profits. However, businesses conducted through our other two VIEs, BHD and Nanjing Recon, are largely unaffected because they are not in the form of trading therefore not subject to the procurement policies to the same extent as ENI is.

• We now have the opportunity to focus more on our own branded equipment and automation system products and services, which we believe are technologically advanced and competitively priced.

- We also have the capability to handle independent construction projects. With fast improvement of our integrated design capabilities and rich experience in construction projects, our management expects to fully utilize our advantages.

In an effort to remediate the adverse effects of the market changes, our management is also actively adjusting our operating structure to strip non-essential businesses and maintain a robust core business. We are also accelerating extensive application of our self-developed technologies and products and expanding our sales network to offset the declines in our trading business.

Growth Strategy

As a smaller local company, it is our basic strategy to focus on developing our onshore oilfield business, i.e. the upstream of the industry. Due to the remote location and difficult environment of China's oil and gas fields, foreign competitors rarely enter those fields.

Large domestic oil companies prefer to focus on their exploration and development businesses to earn higher margins and keep their competitive advantage. With regard to private oilfield service companies, 90% specialize in the manufacture of drilling and production equipment. Thus, the market for technical support and project service is still in its early stage. Our management focuses on providing high quality products and service at oilfields where we have a geographical advantage. Such strategy allows us to avoid conflicts of interest with bigger suppliers of drilling equipment and keep our leading position within the market segment. Our mission is to increase the automation and safety levels of industrial petroleum production in China, and improve its efficiency and effectiveness through advanced technologies. At the same time, we are always looking to improve our business and to increase our earning capability.

Factors Affecting Our Results of Operations

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

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

- growing demand from large corporations for improved management and software designed to enhance corporate performance;

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

- competition and related pricing pressure from other oilfield service solution providers, especially those targeting the oil and gas industry in China;

- the ongoing development of the oilfield service market in China; and

- inflation and other factors.

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

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

- our continued ability to lead and to control all affiliated entities;

- our revenue growth;

- the proportion of our business dedicated to large companies;

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

- our ability to increase our revenues from customers both old and new in the oil and gas industry in China;

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

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

Critical Accounting Policies and Estimates

Estimates and Assumptions

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

Consolidation of VIEs

We recognize an entity as a VIE if it either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. We consolidate a VIE as its primary beneficiary when we have both the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or

the right to receive benefits from the entity that could potentially be significant to the VIE.

Assets recognized as a result of consolidating VIEs do not represent additional assets that could be used to satisfy claims against our general assets. Conversely, liabilities recognized as a result of consolidating these VIEs do not represent additional claims on our general assets; rather, they represent claims against the specific assets of the consolidated VIEs.

Revenue Recognition

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

Hardware

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

Software

The Company sells self-developed software. For software sales, the Company recognizes revenues in accordance with the provisions of Accounting Standards Codification, Topic 985-605, “Software Revenue Recognition,” and related interpretations. Revenue from software is recognized according to project contracts. Contract costs are accumulated during the periods of installation and testing or commissioning. Usually this is short term. Revenue is not recognized until completion of the contracts and receipt of acceptance statements.

Services

The Company provides services to improve software functions and system requirements on separated fixed-price contracts. Revenue is recognized when services are completed and acceptance is determined by a completion report signed by the customer.

Deferred income represents unearned amounts billed to customers related to sales contracts.

Cost of Revenues

When the criteria for revenue recognition have been met, costs incurred are recognized as cost of revenue. Cost of revenues includes wages, materials, handling charges, the cost of purchased equipment and pipes, and other expenses associated with manufactured products and services provided to customers. We expect cost of revenues to grow as our revenues grow. It is possible that we could incur development costs with little revenue recognition, but based upon our past history, we expect our revenues to grow.

Fair Values of Financial Instruments

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

Allowance for Doubtful Accounts

Trade receivables and other receivable accounts are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less a provision made for impairment of these receivables. Provisions are applied to trade and other receivables where events or changes in circumstances indicate that the balance may not be collectible. The identification of doubtful accounts requires the use of judgment and estimates of management. Our management must make estimates of the collectability of our accounts receivable. Management specifically analyzes accounts receivable, historical bad debts, customer creditworthiness, current economic trends

and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our allowance for trade accounts receivable was ¥1,089,331 and ¥2,854,584 ($441,612) on June 30, 2010 and June 30, 2011, respectively. Specifically, allowance for trade accounts receivable - related parties on June 30, 2010 and June 30, 2011 was ¥0 and ¥184,728 ($28,578), respectively. Allowance for other receivables on June 30, 2010 and June 30, 2011 was ¥154,057 and ¥199,635 ($30,884), respectively. There was no allowance for other receivables from related parties.

Valuation of Long-Lived Assets

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

Results of Operations

The following consolidated results of operations include the results of operations of the Company and its VIEs, BHD, Nanjing Recon and ENI (through December 15, 2010). The results of operations are those of the VIEs. On December 16, 2010, ENI changed its equity ownership. We ceased to have the power to direct the activities of ENI, which most significantly impact its economic performance as of that date. As a result of the Company’s determination to deconsolidate ENI, ENI’s results of operations have been consolidated in the Company’s results of operations only through December 15, 2010.

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

Revenue

	For the Years Ended June 30,				Change attributable to:	
	2011	2010	Increase (Decrease)	Percentage Change	Deconsolidation of ENI	Operations
Hardware	¥61,577,356	¥108,351,654	¥(46,774,298)	(43.17 %)	¥(30,977,791)	¥(15,796,507)
Service	—	750,769	(750,769)	(100.00%)	—	(750,769)
Software	2,111,111	7,901,709	(5,790,598)	(73.28 %)	—	(5,790,598)
Total Revenues	¥63,688,467	¥117,004,132	¥(53,315,665)	(45.57 %)	¥(30,977,791)	¥(22,337,874)

Revenues. Our total revenues for the year ended June 30, 2011 were ¥63,688,467 ($9,852,795), a decrease of ¥53,315,665, or 45.57%, from ¥117,004,132 for the year ended June 30, 2010. During this period, our accessory sales business decreased by ¥30,977,791, or 62.38%, automation business decreased by ¥15,482,850, or 51.04%, and our and sales of transportation equipment decreased by ¥6,855,024, or 18.52%. This was mainly caused by:

(1) The decrease of hardware sales, which in turn was mainly caused by the deconsolidation of ENI and the sharp decrease of accessory trading business, in which ENI acted as an agent to obtain purchase orders on our behalf. In light of the ownership change of ENI on December 16, 2010, the Company's Audit Committee concluded that ENI is no longer a VIE and the Company should not include ENI's operations in the Company's operating results starting December 16, 2010. For the year ended June 30, 2011, the revenue decrease contributed by ENI was ¥30,977,791.

i. Some of ENI's large clients, especially Sinopec, adjusted their procurement policies, to increase direct purchases from strategic manufacturers rather than purchase from agencies. Business for ENI therefore decreased gradually since the second half of 2010. For the first three months of 2011, there was less revenue in this category; and

ii. Additionally, our former Chief Marketing Officer, Mr. Li Hongqi, resigned effective January 31, 2011. When Mr. Li resigned, we lost some of our working relationship with Sinopec and other large state-owned companies. Without such relationship, it became difficult for us to compete with large strategic suppliers taken up by the large state-owned oil companies under their new procurement policies.

(2) The discontinuation of cooperative relationships with some small non-oilfield clients because of their unsatisfactory payment records. During the year ended June 30, 2010, we cooperated with some distributing agent

companies which possessed channels for distribution. However, they failed to pay in accordance with the terms of the contracts and our management believes it not in the best interest of the Company to continue cooperation with these companies. Specifically, sales to these companies amounted to ¥8,785,139 ($1,359,087); and

(3) Decrease of hardware sales through related parties, mainly caused by some delays experienced by our end clients in oilfield construction, which in turn caused delays in our projects, so we could not provide equipment to our clients and recognize the corresponding revenue as scheduled.

Cost and Margin

	For the Years Ended June 30,				Change attribute to:	
	2011	2010	Increase (Decrease)	Percentage Change	Deconsolidation of ENI	Operations
Total Revenues	¥63,688,467	¥117,004,132	¥(53,315,665)	(45.57 %)	¥(30,977,791)	¥(22,337,874)
Cost of Revenues	¥43,469,506	¥67,593,524	¥(24,124,018)	(35.69 %)	¥(17,632,489)	¥(6,491,529)
Gross Profit	¥20,218,961	¥49,410,608	¥(29,191,647)	(59.08 %)	¥(13,345,302)	¥(15,846,345)
Margin %	31.75 %	42.23 %	(10.48 %)			

Cost of Revenues. Our cost of revenues includes raw materials and costs related to design, implementation, delivery and maintenance of products and services. All materials and components we need can be purchased or manufactured under contracts. Usually the prices of electronic components do not fluctuate dramatically due to market competition and will not significantly affect our cost of revenues. However, specialized equipment and incentive chemical products may be directly influenced by the price moves of metal and oil. Additionally, the prices of some imported accessories mandated by our clients can also impact our cost.

Our cost of revenues decreased by ¥24,124,018, or 35.69%, from ¥67,593,524 in the year ended June 30, 2010 to ¥43,469,506 ($6,724,862) for the same period in 2011.

(1) The decrease of costs was mainly due to the deconsolidation of ENI, which accounted for ¥17,632,489 ($2,727,798); and

(2) Cost for operations decreased by ¥6,491,529 ($1,004,259), which were mainly due to project delays.

As a percentage of revenues, our cost of revenues increased from 57.77% in the year ended June 30, 2010 to 68.25% in the same period of 2011. This increase was a result of unfinished service projects that had been delayed for which additional costs were incurred during this period. As we move forward with those delayed projects, we expect our revenue to increase and the cost as a percentage of revenues to return to prior levels.

Gross Profit. For the year ended June 30, 2011, our gross profit decreased to ¥20,218,961 ($3,127,933) from ¥49,410,608 for the same period in 2010, a decrease of ¥29,191,647, or 59.08%. For the year ended June 30, 2011, our gross profit as a percentage of revenue decreased to 31.75%, from 42.23% for the same period in 2010. As a result of the decrease in our revenues and an increase in our cost, our gross profit decreased and our gross margin dropped.

Our management believes that a higher margin level is very important to secure our business. The domestic oilfield service industry in China is becoming more and more competitive. Our management believes we need to adjust our business structure to place a greater emphasis on our automation and service project business. We are now switching our role from a primary product supplier to an advanced service integrator. Management believes that specializing in providing packaged customized solutions will increase our long-term competitiveness.

Expenses

	For the Years Ended June 30,				Change attributable to:	
	2011	2010	Increase (Decrease)	Percentage Change	Deconsolidation of ENI	Operations
Selling and distribution expenses	¥7,736,091	¥8,198,742	¥(462,651)	(5.64 %)	¥(299,212)	¥(163,439)
% of revenue	12.15 %	7.01 %	5.14 %	—		
General and administrative expenses	32,055,652	13,269,162	18,786,490	141.58 %	13,197,026	5,589,464
% of revenue	50.33 %	11.34 %	38.99 %	—		
Operating expenses	¥39,791,743	¥21,467,904	¥18,323,839	85.35 %	¥12,897,814	¥5,426,025

Selling and Distribution Expenses. Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing department, sales commissions, costs of our marketing programs (such as public relations, advertising and trade shows), and an allocation of our facilities and depreciation expenses. Selling expenses decreased by ¥462,651 ($71,573), or 5.64%, from ¥8,198,742 for the year ended June 30, 2010 to ¥7,736,091 ($1,196,796) for the same period of 2011. Selling expenses were stable compared to last year. The percentage of selling expenses in relation to revenue increased from 7.01% to 12.15%, mainly caused by the decrease in revenue. Our management believe the selling and distribution expenses are reasonable, and, as our revenue returns to a normal level, selling and distribution expenses as a percentage of revenue will decrease and remain stable in the long run.

General and Administrative Expenses. General and administrative expenses consist primarily of costs from our human resources organization, facilities costs, provision for bad debt, depreciation expenses, professional advisor fees, audit fees and other expenses incurred in connection with general operations. General and administrative expenses increased by ¥18,786,490, or 141.58%, from ¥13,269,162 in the year ended June 30, 2010 to ¥32,055,652 ($4,959,105) for the same period of 2011. Of the increase, ¥13,197,026 ($2,041,619) were caused by the deconsolidation of ENI and the remaining part due to: (1) increased salaries by our VIEs to attract talent, (2) increased expenses related to research and development activities and (3) increased expenses related to our planned secondary offering, which was withdrawn due to unfavorable market conditions. General and administrative expenses were 11.34% of total revenues for the year ended June 30, 2010 and 48.64% of total revenues for the same period in 2011. This percentage increase was primarily attributable to the decrease of revenue and increased expenses attributed to the deconsolidation of ENI.

Net Income

	For the Years ended June 30,			
			Increase	Percentage
	2011	2010	(Decrease)	Change
Income (loss) from operations	¥(19,572,782)	¥27,942,704	¥(47,515,486)	(170.05 %)
Interest income	1,463	10,476	(9,013)	(86.03 %)
Interest expense	(564,654)	(214,431)	350,223	163.33 %
Other income	279,664	444,567	(164,903)	(37.09 %)
Subsidy income	822,545	2,132,880	(1,310,335)	(61.44 %)
Loss on deconsolidation	(8,989,614)	—	(8,989,614)	—
Net income (loss) before income taxes	(28,023,378)	30,316,196	(58,339,574)	(192.44 %)
Provision for income taxes	(665,146)	(7,504,877)	(6,839,731)	(91.14 %)
Net income attributable to non-controlling interest	(347,851)	(2,752,780)	(2,404,929)	(87.36 %)
Net income (loss) attributable to common shareholders	¥(29,036,375)	¥20,058,539	¥(49,094,914)	(244.76 %)

Income (Loss) from Operations. Loss from operations was ¥19,572,782 ($3,027,968) for the year ended June 30, 2011, compared to income from operations of ¥27,942,704 for the same period of 2010. As a result of the deconsolidation of ENI, lower revenues and higher administrative expenses, income from operations decreased during this period.

Subsidy Income. We received grants of ¥2,132,880 and ¥822,545 ($127,250) from the local government for the years ended June 30, 2010 and 2011, respectively. These grants were given by the government in the form of income tax return to support local companies in developing advanced technologies and improving their products. Subsidy income for 2010 was higher because we received one-off grants for becoming a public company.

Loss on Deconsolidation. As a result of the deconsolidation of ENI, we suffered a loss of ¥8,989,614 ($1,390,720), which amount was measured as the difference between (a) the aggregate of (i) the fair value of any consideration received, (ii) the fair value of the retained non-controlling investment in ENI at the date in which ENI was deconsolidated, and (iii) the carrying amount of any non-controlling interest in ENI; and (b) the carrying value of the net assets and liabilities of ENI as of December 15, 2010. Our management believes it was an unusual loss and is in the process of initiating a series of safeguards to prevent this from happening in the future.

Income Tax Expense. Income tax is provided based upon the liability method of accounting pursuant to ASC Topic 740, “Accounting for Income Taxes.” Under this approach, deferred income taxes are recorded to reflect the tax consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts. A valuation allowance is recorded against deferred tax assets if it is not likely that the asset will be realized.

We have not been subject to any income taxes in the United States or the Cayman Islands. Enterprises doing business in PRC are generally subject to enterprise income tax at a rate of 25%; however, Nanjing Recon and BHD were granted certifications of High Technology Enterprise and are taxed at a rate of 15% for taxable income generated. The applicable tax rate for each of our subsidiaries changed in the past few years because of their qualifications and different local policies. For calendar years 2010 and 2011, Nanjing Recon and BHD were taxed at a rate of 15% and ENI was taxed at 25%. Our effective EIT burden will vary, depending on which of our Domestic Companies generate greater revenues. Income tax expense for the years ended June 30, 2010 and 2011 was ¥7,504,877 and ¥665,146 ($102,900), respectively. This decrease was mainly due to a decrease in taxable operating income.

Net Income (Loss) Attributable to Ordinary Shareholders. As a result of the factors described above, net loss attributable to ordinary shareholders was ¥29,036,375 ($4,492,015) for the year ended June 30, 2011, a decrease of ¥49,094,914, or 244.76%, over net income of ¥20,058,539 for the same period of 2010.

Adjusted EBITDA

	For the Years Ended June 30,				
	2011 RMB	2010 RMB	Increase (Decrease)	Percentage Change	2011 **U.S. Dollars**
Reconciliation of Adjusted EBITDA from Net Income (Loss):					
Net income (loss)	¥(28,688,524)	¥22,811,319	¥(51,499,843)	(225.76%)	$(4,438,201)
Income tax expense	665,146	7,504,877	(6,839,731)	(91.14%)	102,900
Interest expense	564,654	214,431	350,223	163.33%	87,354
Stock compensation expense	1,420,588	1,623,034	(202,446)	(12.47%)	219,769
Depreciation and amortization	361,837	368,804	(6,967)	(1.89%)	55,977
Loss on deconsolidation	8,989,614	—	8,989,614		1,390,720
Adjusted EBITDA	¥(16,686,685)	¥32,522,465	¥(49,209,150)	(151.31%)	$(2,581,481)

Adjusted EBITDA. We define adjusted EBITDA as net income (loss) adjusted for income tax expense, interest expense, non-cash stock compensation expense, and depreciation, amortization expense. We believe it is useful to an equity investor in evaluating our operating performance because (1) it is widely used by investors in our industry to measure a company's operating performance without regard to items such as interest expense, depreciation and amortization, which can vary substantially from company to company depending upon accounting methods, the book value of assets, the capital structure and the method by which the assets were acquired; and (2) it helps investors more meaningfully evaluate and compare the results of our operations from period to period by removing the impact of our capital structure and asset base from our operating results.

Adjusted EBITDA decreased by ¥49,209,150, or 151.31%, to a loss of ¥16,686,685 ($2,581,481) for the year ended June 30, 2011 compared to the same period in 2010. This was due to adverse operating results of ENI, especially the non-collectable purchase advance, loss of deconsolidation, the construction delays experienced by some of our customers and the extra expenses associated with our annual meeting and our withdrawn secondary offering. These factors caused revenues during the period to decrease while our administrative expenses increased. Compared to the 244.76% decrease in net income (loss) attributable to ordinary shareholders, we believe EBITDA more accurately reflects our operations.

Liquidity and Capital Resources

Cash and Cash Equivalents. Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than six months. As of June 30, 2011, we had cash and cash equivalents in the amount of ¥3,485,944 ($539,286).

Indebtedness. As of June 30, 2011, except for ¥1,743,286 ($269,692) of short-term borrowings, ¥911,399 ($140,996) of short-term borrowings from related parties, and ¥5,000,000 ($773,515) commercial loan from a local bank, we did not have any finance leases or purchase commitments, guarantees or other material contingent liabilities.

Holding Company Structure. We are a holding company with no operations of our own. All of our operations are conducted through the Domestic Companies. As a result, our ability to pay dividends and to finance any debt that we may incur is dependent upon the receipt of dividends and other distributions from the Domestic Companies. In addition, Chinese legal restrictions permit payment of dividends to us by our Domestic Companies only out of its accumulated net profit, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, the Domestic Companies are required to set aside a portion (at least 10%) of their after-tax net income (after discharging all cumulated loss), if any, each year for compulsory statutory reserve until the amount of the reserve reaches 50% of the Domestic Companies' registered capital. These funds may be distributed to shareholders at the time of wind-up. When we were incorporated in the Cayman Islands in August 2007, 5,000,000 ordinary shares were authorized, and 50,000 ordinary shares were issued to Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi, at a par value of $0.01 each. On December 10, 2007, our company sold 2,632 ordinary shares to an investor at an aggregate consideration of $200,000. On June 8, 2009, in connection with our initial public offering, the Board of Directors approved a 42.7840667-to-1 split of ordinary shares and redeemable ordinary shares to shareholders of record as of such date. After giving effect to the share split of our ordinary shares and the completion of our initial public offering, we had 3,951,811 ordinary shares outstanding.

On December 16, 2010, in light of the change of the ownership of ENI, we ceased to have the power to direct the activities of ENI, which as of that date most significantly impact its economic performance. As a result, ENI ceased to be our VIE starting from the same date.