UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A

AMENDMENT NO. 2

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009

OR

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

Commission file number 000-53052

SMARTHEAT INC.
(Exact name of registrant as specified in its charter)

NEVADA (State or other jurisdiction of incorporation or organization)	98-0514768 (IRS Employer Identification No.)

A-1, 10, Street 7
Shenyang Economic and Technological Development Zone
Shenyang, China
110027
(Address of principal executive offices, including zip code.)

+86 (24) 2519-7699
(telephone number, including area code)

(Former name or former address, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days.
YES x NO ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (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 Exchange Act). YES¨ NO x

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 24,179,900 shares as of May 10, 2009.

EXPLANATORY NOTE

This Amendment No. 2 to the SmartHeat Inc. (the "Company") 10-Q originally filed on May 11, 2009 is being filed solely to updated the original 10-Q to be consistent with comments made by the staff of the Securities and Exchange Commission on the Company's Form S-1 which became effective on June 23,2009. The Company updated Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) to clarify the impact that payment schedules and delays may have on its cash flows and liquidity, added two risk factors in Risk Factors (Item 1-A) and revised Notes to Consolidated Financial Statements to explain the recognition of non-material after sales service charges. All other items and exhibits contained in the Form 10-Q as filed on May 11, 2009 and as amended on May 22, 2009 remain unchanged.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

SMARTHEAT, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	AS OF MARCH 31, 2009	AS OF DECEMBER 31, 2008
ASSETS		
CURRENT ASSETS		
Cash & cash equivalents	$ 737,652	$ 1,435,212
Restricted cash	437,564	462,048
Accounts receivable, net	10,144,431	11,390,169
Retentions receivable	388,158	290,852
Advances to suppliers	1,259,750	412,524
Other receivables, prepayments and deposits	661,710	698,834
Inventories	8,150,511	6,107,583
Note and acceptances receivable	53,493	14,631
Total current assets	21,833,269	20,811,853
NON-CURRENT ASSETS		
Restricted cash	196,467	219,472
Accounts receivable, net	57,052	310,810
Retentions receivable	645,159	166,912
Intangible assets, net	1,113,375	1,155,131
Property and equipment, net	2,391,418	2,436,553
Total noncurrent assets	4,403,471	4,288,878
TOTAL ASSETS	$ 26,236,740	$ 25,100,731
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 2,450,794	$ 1,210,906
Unearned revenue	1,088,984	850,408
Taxes payable	163,020	1,327,775
Accrued liabilities and other payables	1,136,028	1,330,812
Due to minority shareholder	-	5,303
Loans payable	2,442,985	2,443,450
Total current liabilities	7,281,811	7,168,654
DEFERRED TAX LIABILITY	38,725	38,854

COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS' EQUITY				
Common stock, $0.001 par value; 75,000,000 shares authorized, 24,179,900 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively		24,180		24,180
Paid in capital		8,223,453		8,223,453
Statutory reserve		1,267,058		1,150,542
Accumulated other comprehensive income		986,339		984,629
Retained earnings		8,415,174		7,510,419
Total stockholders' equity		18,916,204		17,893,223
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	26,236,740	$	25,100,731

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

1

SMARTHEAT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME

	FOR THE THREE MONTHS ENDED MARCH 31, 2009	2008
Net sales	$ 6,207,503	$ 3,079,051
Cost of goods sold	3,900,947	2,112,956
Gross profit	2,306,556	966,095
Operating expenses		
Selling expenses	460,913	197,421
General and administrative expenses	569,522	284,145
Total operating expenses	1,030,435	481,566
Income from operations	1,276,121	484,529
Non-operating income (expenses)		
Interest income	16,681	147,138
Interest expense	(52,852)	(66,628)
Financial expense	(1,840)	-
Other income	760	11,181
Total non-operating income (expenses)	(37,251)	91,691
Income before income tax	1,238,870	576,220
Income tax expense	217,601	104,957
Net income	1,021,269	471,263
Other comprehensive item		
Foreign currency translation	1,710	242,094
Comprehensive Income	$ 1,022,979	$ 713,357
Basic weighted average shares outstanding	24,179,900	18,500,000
Diluted weighted average shares outstanding	24,184,174	18,500,000
Basic earnings per share	$ 0.04	$ 0.03
Diluted earnings per share	$ 0.04	$ 0.03

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

2

SMARTHEAT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR THE THREE MONTHS ENDED MARCH 31, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,021,269	$ 471,263
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	96,684	48,875
Unearned interest on accounts receivable	28,854	(143,793)
Decrease in deferred tax liability	(122)	-
(Increase) decrease in current assets:		
Accounts receivable	1,073,545	(47,140)
Retentions receivable	(575,657)	(275,347)
Advances to suppliers	(838,551)	(907,320)
Other receivables, prepayments and deposits	(608,803)	(220,372)
Inventories	(2,044,149)	589,796
Increase (decrease) in current liabilities:		
Accounts payable	1,596,204	719,555
Unearned revenue	238,745	385,532
Taxes payable	(1,164,537)	(693,038)
Accrued liabilities and other payables	442,319	(97,128)
Net cash used in operating activities	(734,199)	(169,117)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in restricted cash	47,361	116,033
Acquisition of property & equipment	(10,474)	(37,761)
Net cash provided by investing activities	36,887	78,272
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment to shareholder	-	(25,890)
Loans payable	-	(172,563)
Net cash used in financing activities	-	(198,453)
EFFECT OF EXCHANGE RATE CHANGE ON CASH & CASH EQUIVALENTS	(248)	9,517
NET DECREASE IN CASH & CASH EQUIVALENTS	(697,560)	(279,781)
CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD	1,435,212	393,147
CASH & CASH EQUIVALENTS, END OF PERIOD	$ 737,652	$ 113,366
Supplemental Cash flow data:		

Income tax paid	$	777,627	$	104,957
Interest paid	$	60,316	$	40,498

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

SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009 (UNAUDITED) AND DECEMBER 31, 2008

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

SmartHeat Inc., formerly known as Pacific Goldrim Resources, Inc. (the “Company” or “SmartHeat”), was incorporated on August 4, 2006 in the State of Nevada. The Company is engaged in the manufacturing and sale of plate heat exchangers and various packages, thermometer testing devices and heat usage calculators through its wholly owned operating subsidiaries in China.

On April 14, 2008, the Company entered into a Share Exchange Agreement with Shenyang Taiyu Machinery and Electronic Equipment Co., Ltd. ("Taiyu") and the Taiyu Shareholders. The Company issued 18,500,000 shares of its common stock to the shareholder of Taiyu in exchange for all of the equitable and legal rights, title and interests in and to Taiyu's share capital in the amount of RMB 25,000,000. Concurrent with the share exchange, one of SmartHeat’s shareholders cancelled 2,500,000 shares out of 6,549,900 of total issued and outstanding shares of SmartHeat pursuant to the Split-Off Agreement dated April 14, 2008. As a result of the share exchange and the cancellation of the 2,500,000 shares of the Company's common stock, there were 22,549,900 shares of the Company's common stock issued and outstanding, approximately 82.04% of which was held by the former Taiyu Shareholders. The shareholders of the Company immediately prior to the completion of these transactions held the remaining 17.96% of the issued and outstanding share capital of SmartHeat. Taiyu became a wholly-owned subsidiary of SmartHeat.

Prior to the acquisition of Taiyu, the Company was a non-operating public shell. Pursuant to Securities and Exchange Commission ("SEC") rules, the merger or acquisition of a private operating company into a non-operating public shell with nominal net assets is considered a capital transaction in substance, rather than a business combination. Accordingly, for accounting purposes, the transaction was treated as a reverse acquisition and a recapitalization, and pro-forma information is not presented. Transaction costs incurred in the reverse acquisition were charged to expense.

Taiyu was incorporated in the Liaoning Province, People’s Republic of China (“PRC” or "China") in July, 2002. Taiyu is engaged in manufacturing and sale of plate heat exchangers and various packages, thermo meter testing devices and heat usage calculators. The Company is an authorized dealer of the SONDEX brand; SONDEX is the second largest plate heat exchanger manufacturer in the world.

On September 25, 2008, the Company entered into a Share Exchange Agreement (the "Agreement") between Asialink (Far East) Limited ("Asialink") and the Company providing for the acquisition by the Company from Asialink of all of the outstanding capital stock of SanDeKe Co., Ltd., a Shanghai based manufacturer of heat plate exchangers ("SanDeKe"). The purchase price for the SanDeKe shares was $741,516, of which $222,455 was payable within 15 days after the signature date of the Agreement, $370,758 was payable within 15 days after all necessary documents have been filed with government agencies, and $148,303 of which is payable within 15 days after the purchase has been approved and registered by the government agencies. Under the terms of the Agreement, two of the shareholders of SanDeKe agreed not to compete with the business of SanDeKe for a period of four years after the completion of the purchase. At March 31, 2009, the Company has paid $593,213; the balance of $148,303 will be paid once the title is officially transferred to the Company.

The unaudited financial statements have been prepared by the Company, pursuant to the rules and regulations of the SEC. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the 2008 audited financial statements and footnotes included in the Company’s audited financial statements. The results for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year ending December 31, 2009.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of SmartHeat, Taiyu and SanDeKe. For purposes of this Quarterly Report, the "Company" refers collectively to SmartHeat, SanDeKe, and Taiyu. All significant inter-company accounts and transactions have been eliminated in consolidation.

SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009 (UNAUDITED) AND DECEMBER 31, 2008

Use of Estimates

In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America ("US GAAP"), management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting year. Significant estimates, required by management, include the recoverability of long-lived assets, allowance for doubtful accounts, and the reserve for obsolete and slow-moving inventories. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of March 31, 2009 and December 31, 2008, the Company maintained total restricted cash of $634,031 and $681,520, respectively, in several bank accounts, representing cash deposits from customers for securing payment from customers that occurs no later than the warranty period expires, of which, $437,564 and $462,048 was the cash that will be released to the Company within one year. Restricted cash is held in an interest bearing bank account.

Accounts and Retentions Receivable

The Company's policy is to maintain reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Based on historical collection activity, the Company had allowances of $629,568 and $629,687 at March 31, 2009 and December 31, 2008, respectively.

At March 31, 2009 and December 31, 2008, the Company had retentions receivable from customers for product quality assurance of $1,033,317 and $457,764, respectively. The retention rate varies from 5% to 20% of the sales price with variable terms from three months to two years depending on the shipping date of the products and the number of heating seasons that the warranty period covers.

Accounts receivable is net of unearned interest of $57,374 and $28,526 at March 31, 2009 and December 31, 2008, respectively. Unearned interest represents imputed interest on accounts receivable with due dates over one year from the invoice date discounted at the Company's borrowing rate, currently 7.16%, and it was 7.04% in 2008.

Inventories

Inventories are valued at the lower of cost or market with cost determined on a moving weighted average basis. Cost of work in progress and finished goods comprises direct material, direct production cost and an allocated portion of production overheads.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are expensed as incurred; additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method with a 10% salvage value and estimated lives ranging from 5 to 20 years as follows:

Building	20 years
Vehicles	5 years
Office Equipment	5 years
Production Equipment	5-10 years

Land Use Right

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

SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009 (UNAUDITED) AND DECEMBER 31, 2008

Impairment of Long-Lived Assets

Long-lived assets, which include property, plant and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the assets. Fair value is generally determined using the asset's expected future discounted cash flows or market value, if readily determinable. Based on its review, the Company believes that, as of March 31, 2009 and December 31, 2008, there were no significant impairments of its long-lived assets.

Warranties

The Company offers warranty to all customers on its products for a period of one or two heating seasons depending on the contract terms negotiated with the customers. The Company accrues for warranty costs based on estimates of the costs that may be incurred under its warranty obligations. The warranty expense and related accrual is included in the Company's selling expenses and other payable respectively, and is recorded at the time revenue is recognized. Factors that affect the Company's warranty liability include the number of sold units, its estimates of anticipated rates of warranty claims, costs per claim and estimated support labor costs and the associated overhead. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

The Company's warranty reserve at March 31, 2009 and December 31, 2008 are as follows:

	March 31, 2009	December 31, 2008
Beginning balance	$ -	$ -
Provisions made	76,570	95,000
Changes in estimates	-	-
Actual costs incurred	(12,906)	(95,000)
Ending balance	$ 63,664	-
Warranty reserve in current liabilities	$ 63,664	-

Income Taxes

The Company utilizes Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

The Company adopted the provisions of the Financial Accounting Standards Board's ("FASB") Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. As a result of the implementation of FIN 48, the

Company made a comprehensive review of its portfolio of tax positions in accordance with recognition standards established by FIN 48. As a result of the implementation of Interpretation 48, the Company recognized no material adjustments to liabilities or shareholders' equity. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009 (UNAUDITED) AND DECEMBER 31, 2008

Interest associated with unrecognized tax benefits is classified as interest expense and penalties are classified as selling, general and administrative expense in the statements of income. The adoption of FIN 48 did not have a material impact on the Company’s financial statements.

Revenue Recognition

The Company's revenue recognition policies are in compliance with SEC Staff Accounting Bulletin (“SAB”) 104. Sales revenue is recognized when products are delivered and for PHE and PHE units, when customer acceptance occurs, the price is fixed or determinable, no other significant obligations of the Company exist and collectibility is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are recorded as unearned revenue.

The Company’s sales contracts with the customers generally provide that 30% of the purchase price is due upon the placement of an order, 30% is due on delivery, 30% is due upon installation and acceptance of the equipment after customer testing, the final 10% of the purchase price is due on a date that is no later than the termination date of the standard warranty period.

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

Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not affected by the income tax holiday.

Sales returns and allowances were $0 for both the three months ended March 31, 2009 and 2008. The Company does not provide right of return, price protection or any other concessions to its customers.

The standard warranty of the Company is provided to all customers and is not considered an additional service; rather it is considered an integral part of the product’s sale. The Company believes that the existence of its standard product warranty in a sales contract does not constitute a deliverable in the arrangement and thus there is no need to apply the EITF 00-21 separation and allocation model for a multiple deliverable arrangement. FAS 5 specifically address the accounting for standard warranties and neither SAB 104 nor EITF 00-21 supersedes FAS 5. The Company believes that accounting for its standard warranty pursuant to FAS 5 does not impact revenue recognition because the cost of honoring the warranty can be reliably estimated.

The Company provides after sales services at a charge after expiration of the warranty period, with after sales services mainly consisting of cleaning plate heat exchangers and repairing and exchanging parts. The Company recognizes such revenue when service is provided. For the three months ended March 31, 2009 and 2008, revenue from after sales services after expiration of the warranty period was approximately $1,700 and $5,600, respectively.

Cost of Goods Sold

Cost of goods sold consists primarily of material costs, direct labor, and manufacturing overhead which are directly attributable to the production of products. Write-down of inventories to lower of cost or market is also recorded in cost of goods sold.

Concentration of Credit Risk

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

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

Statement of Cash Flows

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

SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009 (UNAUDITED) AND DECEMBER 31, 2008

Basic and Diluted Earnings per Share (EPS)

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

The following table presents a reconciliation of basic and diluted earnings per share:

	For the Three Months Ended March 31	
	2009	2008
Net income	$ 1,021,269	$ 471,263
Weighted average shares outstanding – basic	24,179,900	18,500,000
Effect of dilutive securities:		
Unexercised warrants and options	4,274	—
Weighted average shares outstanding – diluted	24,184,174	18,500,000
Earnings per share – basic	$ 0.04	$ 0.03
Earnings per share – diluted	$ 0.04	$ 0.03

Fair Value of Financial Instruments

SFAS No. 107, “Disclosures about Fair Value of Financial Instruments,” requires the Company disclose estimated fair values of financial instruments. The carrying amounts reported in the statements of financial position for current assets and current liabilities qualifying as financial instruments are a reasonable estimate of fair value.

Foreign Currency Translation and Comprehensive Income (Loss)

The accounts of the Company’s Chinese subsidiaries are maintained in the Chinese Yuan Renminbi (RMB) and the accounts of the U.S. parent company are maintained in the U.S. Dollar (USD). The accounts of the Chinese subsidiaries were translated into USD in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation," with the RMB as the functional currency for the Chinese subsidiaries. According to the Statement, all assets and liabilities were translated at the exchange rate on the balance sheet date, stockholders’ equity are translated at the historical rates and statement of operations items are translated at the weighted average exchange rate for the year. The resulting translation adjustments are reported under other comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income”.

Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with SFAS No. 123R, “Share-Based Payment, an Amendment of FASB Statement No. 123.” The Company recognizes in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees and non-employees.

Segment Reporting

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

SMARTHEAT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009 (UNAUDITED) AND DECEMBER 31, 2008

SFAS 131 has no effect on the Company's financial statements as substantially all of the Company's operations are conducted in one industry segment. All of the Company's assets are located in the PRC.

Registration Rights Agreement

The Company accounts for payment arrangements under registration rights agreement in accordance with FASB Staff Position EITF 00-19-2, which requires that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies.

The Company is required to file the Registration Statement with the SEC within 60 days of the closing of the private placement offering. The Registration Statement must be declared effective by the SEC within 180 days of the final closing of the offering. Subject to certain grace periods, the Registration Statement must remain effective and available for use until the Investors can sell all of the securities covered by the Registration Statement without restriction pursuant to Rule 144. If the Company fails to meet the filing or effectiveness requirements of the Registration Statement, the Company is required to pay liquidated damages of 2% of the aggregate purchase price paid by such Investor for any Registrable Securities then held by such Investor on the date of such failure and on each anniversary of the date of such failure until such failure is cured. The last closing under the private placement occurred on September 24, 2008 and the 180 day period for effectiveness of the registration statement under the Registration Rights Agreement ended on March 23, 2009. At March 31, 2009, the Company became liable to pay approximately $110,000 liquidated damages to our investors as a result of failure to declare the effectiveness of the Registration Statement within 180 days of the final closing of the offering. The liquidated damages have been recorded as the Company’s expense with charging corresponding account to accrued liabilities.

New Accounting Pronouncements

Employer’s Disclosures about Postretirement Benefit Plan Assets

In December 2008, the FASB issued FSP FAS 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets” (“FSP FAS 132(R)-1”). FSP FAS 132(R)-1 applies to an employer that is subject to the disclosure requirements of SFAS No. 132 (revised 2003), “Employers’ Disclosures about Pensions and Other Postretirement Benefits” (“SFAS 132R”) and amends SFAS 132R to provide guidance on an employer’s disclosures about plan assets of a defined benefit pension or other postretirement plan. The disclosures about plan assets required by FSP FAS 132(R)-1 shall be provided for fiscal years ending after December 15, 2009. Earlier application is permitted. The adoption of FSP FAS 132(R)-1 did not have a material impact on its financial statements.

Accounting for Defensive Intangible Assets

In November 2008, the FASB issued EITF Issue No. 08-7, “Accounting for Defensive Intangible Assets” (“EITF 08-7”). EITF 08-7 applies to all acquired intangible assets in situations in which the acquirer does not intend to actively use the asset but intends to hold the asset to prevent its competitors from obtaining access to the asset (a defensive intangible asset). Defensive intangible assets could include assets that the acquirer will never actively use, as well as assets that will be used by the acquirer during a transition period when the intention of the acquirer is to discontinue the use of those assets. EITF 08-7 concluded that a defensive intangible asset should be accounted for as a separate unit of accounting and should be amortized over the period that the defensive intangible asset directly or indirectly contributes to the future cash flows of the entity. EITF 08-7 is effective prospectively for intangible assets acquired on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application is not permitted. The adoption of EITF 08-7 did not have a material impact on its financial statements.

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Accounting for Financial Guarantee Insurance Contracts

In May 2008, FASB issued SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60.” The scope of this Statement is limited to financial guarantee insurance (and reinsurance) contracts, as described in this Statement, issued by enterprises included within the scope of Statement 60. Accordingly, this Statement does not apply to financial guarantee contracts issued by enterprises excluded from the scope of Statement 60 or to some insurance contracts that seem similar to financial guarantee insurance contracts issued by insurance enterprises (such as mortgage guaranty insurance or credit insurance on trade receivables). This Statement also does not apply to financial guarantee insurance contracts that are derivative instruments included within the scope of FASB Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities.” The adoption of SFAS No. 163 did not have a material impact on its financial statements.

The Hierarchy of Generally Accepted Accounting Principles

In May 2008, FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles.” SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS 162 adoption did not have an impact on the Company’s financial statements.

Determination of the Useful Life of Intangible Assets

In April 2008, the FASB issued FASB Staff Position FAS 142-3, “Determination of the Useful Life of Intangible Assets” (“FSP FAS 142-3”). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”), and requires additional disclosures. The objective of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141 (R), “Business Combinations” (“SFAS 141(R)”), and other accounting principles generally accepted in the United States of America. FSP FAS 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The guidance for determining the useful life of intangible assets shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements apply prospectively to all intangible assets recognized as of, and subsequent to, the effective date. Early adoption is prohibited. The adoption of FSP FAS 142-3 did not have a material impact on its financial statements.

Disclosures about Derivative Instruments and Hedging Activities

In March 2008, FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133.” SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008, the adoption of SFAS 161 did not have a significant impact on its results of operations or financial position.

Fair value of measurements

On January 1, 2008, the Company adopted SFAS No. 157, “Fair Value Measurements,” SFAS 157 defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosures requirements for fair value measurements. The three levels are defined as follow:

· Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

· Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

· Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

As of March 31, 2009, the Company did not identify any assets and liabilities that are required to be presented on the balance sheet at fair value.

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Non-Controlling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51

In December 2007, FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51." SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements and separate from the parent’s equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent’s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company expects SFAS 160 will have an impact on accounting for business combinations, but the effect is dependent upon acquisitions at that time. The Company adopted the provisions of SFAS 160 on January 1, 2009.

Business Combinations

SFAS 141 (Revised 2007), Business Combinations (SFAS 141(R)), is effective for the Company for business combinations for which the acquisition date is on or after January 1, 2009. SFAS 141(R) changes how the acquisition method is applied in accordance with SFAS 141. The primary revisions to this Statement require an acquirer in a business combination to measure assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, at their fair values as of that date, with limited exceptions specified in the Statement. This Statement also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with the Statement). Assets acquired and liabilities assumed arising from contractual contingencies as of the acquisition date are to be measured at their acquisition-date fair values, and assets or liabilities arising from all other contingencies as of the acquisition date are to be measured at their acquisition-date fair value, only if it is more likely than not that they meet the definition of an asset or a liability in FASB Concepts Statement No. 6, Elements of Financial Statements. This Statement significantly amends other Statements and authoritative guidance, including FASB Interpretation No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, and now requires the capitalization of research and development assets acquired in a business combination at their acquisition-date fair values, separately from goodwill. FASB Statement No. 109, Accounting for Income Taxes, was also amended by this Statement to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. The Company expects SFAS 141R will have a significant impact on accounting for business combinations, but the effect is dependent upon acquisitions at that time. The Company adopted the provisions of SFAS 160 on January 1, 2009.

Accounting for Non-Refundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities

In June 2007, FASB issued FASB Staff Position No. EITF 07-3, “Accounting for Nonrefundable Advance Payments for Goods or Services Received for use in Future Research and Development Activities,” which addresses whether non-refundable advance payments for goods or services that used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed. EITF 07-03 is effective for fiscal years beginning after December 15, 2008. The adoption of EITF 07-03 did not have a significant impact on the Company’s financial statements.

3. INVENTORIES

Inventories at March 31, 2009 and December 31, 2008 were as follows:

	March 31, 2009	December 31, 2008
Raw materials	$ 5,527,347	$ 4,411,298
Work in process	550,020	652,472
Finished Goods	2,073,144	1,043,813
Total	$ 8,150,511	$ 6,107,583

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4. PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following at March 31, 2009 and December 31, 2008:

	March 31, 2009	December 31, 2008
Building	$ 1,818,481	$ 1,818,827
Production equipment	440,982	441,065
Office equipment	242,403	231,975
Vehicles	300,899	300,956
	2,802,765	2,792,823
Less: Accumulated depreciation	(411,347)	(356,270)
	$ 2,391,418	$ 2,436,553

Depreciation expense for the three months ended March 31, 2009 and 2008 was approximately $55,000 and $38,000, respectively.

5. OTHER RECEIVABLES, PREPAYMENTS AND DEPOSITS

Other receivables, prepayments and deposits consisted of the following at March 31, 2009 and December 31, 2008, respectively:

	March 31, 2009	December 31, 2008
Cash advance to third parties	$ 129,391	$ 89,628
Deposit for public bids	238,634	353,399
Prepayment for freight and related insurance expenses	98,387	95,888
Deposits	7,652	42,783
Advance to employees	187,646	117,136
Total	$ 661,710	$ 698,834

Cash advance to third parties was the short term cash advances to customers and vendors with repayment usually within three to six months. Deposits for public bidding represented the deposits for bidding expected contracts, which will be returned to the Company after the bidding process is completed unusually within three to four months from the payment date. Prepayment for freight and /or related insurance expenses represented prepaid shipping and freight insurance expenses for customers and is generally repaid upon customer receipt of products. Deposits mainly consisted of deposits for rents and utilities. Cash advance to employees mainly represented short term loan to employees and advance to employees for business trip and related expenses. Other receivables, prepayments and deposits are reimbursed or settled within 12 months.

6. INTANGIBLE ASSETS

Intangible assets mainly consisted of land use rights, computer software, know-how technology, customer list and covenant not to compete. All land in the PRC is government owned and cannot be sold to any individual or company. However, the government grants the user a “land use right” to use the land. The Company acquired land use rights during 2005 for approximately $440,000 (RMB 3,549,682). The Company has the right to use the land for 50 years and is amortizing such rights on a straight-line basis for 50 years.

Intangible assets consisted of the following at March 31, 2009 and December 31, 2008, respectively:

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	March 31, 2009	December 31, 2008
Land use right	$ 519,271	$ 519,369
Know-how technology	266,757	266,808
Customer list	191,615	191,652
Covenant not to compete	104,238	104,258
Software	190,130	190,166
	1,272,011	1,272,253
Less: accumulated amortization	(158,636)	(117,122)
	$ 1,113,375	$ 1,155,131

Amortization expense of intangible assets for the three month ended March 31, 2009 and 2008 was approximately $42,000 and $10,100, respectively. Annual amortization expense for the next five years at March 31, 2009 is expected to be: $180,000, $180,000, $180,000, $180,000 and $140,000.

7. MAJOR CUSTOMERS AND VENDORS

Four and three customers accounted for 50% and 59% of the Company's net revenue for the three months ended March 31, 2009 and 2008, respectively. For the three months ended March 31, 2009, each customer accounted for about 18%, 16%, 12%, and 5% of the sales. For the three months ended March 31, 2008, each customer accounted for about 25%, 21% and 14% of the sales. At March 31, 2009 and 2008, the total receivable balance due from these customers was approximately $3,319,000 and $1,717,000, respectively.

One major vendor provided 11% and 9% of the Company's purchases of raw materials for the three months ended March 31, 2009 and 2008, respectively. The Company had approximately $110,000 and $291,000 in accounts payable to this vendor at March 31, 2009 and 2008, respectively.

8. TAXES PAYABLE

Taxes payable consisted of the following at March 31, 2009 and December 31, 2008:

	March 31, 2009	December 31, 2008
Income tax payable	$ 163,932	$ 723,958
Value added tax payable (receivable)	(10,014)	597,676
Other taxes payable	9,102	6,141
	$ 163,020	$ 1,327,775

9. ACCRUED LIABILITIES AND OTHER PAYABLES

Accrued liabilities and other payables consisted of the following at March 31, 2009 and December 31, 2008:

	March 31, 2009	December 31, 2008
Advance from third parties	$ 449,914	$ 453,625

Payable for purchase of SanDeKe	148,303	741,516
Other payables	261,886	99,418
Warranty reserve	63,664	-
Accrued liabilities	212,261	36,253
Total	$ 1,136,028	$ 1,330,812

Advance from third parties represented short term, non interest bearing advances from third parties. Other payables consisted of payables for the Company's miscellaneous expenses including postage, business insurance, employee benefits, bidding fee, etc. Accrued liabilities mainly consisted of accrued interest, payroll, utility, and liquidated damages for failure to declare the effectiveness of the Registration Statement within 180 days of the final closing of the offering.

10. LOANS PAYABLE

The Company is obligated for the following short term loans payable as of March 31, 2009 and December 31, 2008:

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	March 31, 2009	December 31, 2008
Loan from a commercial bank in the PRC for 6,000,000 RMB. This loan was entered into on Apr 28, 2007 and was due on Apr 12, 2008. This loan was renewed on Apr 12, 2008 with new maturity date on June 13, 2009. This loan currently bears interest at 7.159%. The Company pledged its building in the value of approximately RMB 12,430,950 or approximately $1,818,000 for this loan.	$ 877,719	$ 877,886
The Company entered into a series of short term loans during 2006 and 2007 with a third party company in the PRC for total of 10, 300,000 RMB. Some of the loans matured on various dates in 2008 and some of the loans are payable on demand. These loans bear variable interest at 8.591% for 2008 and 6.903% for 2007. The Company repaid RMB 2,600,000 in 2008 and had RMB 7,700,000 outstanding as of March 31, 2009, due on December 31, 2009 with interest of 8.591%.	1,126,406	1,126,621
The Company entered into a one year loan on July 1, 2008 with another third party company in the PRC for total of 3,000,000 RMB. This loan is due on December 31, 2009 with interest of 8.591%.		