Sino Clean Energy Inc
Form 424B4
December 22, 2010

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Filed Pursuant to Rule 424(b)(4)
Registration No. 333-167560

SINO CLEAN ENERGY, INC.

5,465,000 Shares of Common Stock

We are offering 5,465,000 shares of our common stock. As of June 14, 2010, our common stock was listed on the NASDAQ Global Market and commenced trading under the symbol "SCEI." Previously, our common stock was quoted on the Over the Counter Bulletin Board under the symbol "SCLX."

The last reported market price of our shares of common stock on December 21, 2010 was $5.67.

Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 11 for certain factors relating to an investment in our securities. Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$ 5.2500	$ 28,691,250.00
Underwriting discounts and commissions(1)	$ 0.3675	$ 2,008,387.50
Proceeds to us, before expenses	$ 4.8825	$ 26,682,862.50

(1) See "Underwriting" for a description of compensation payable to the underwriters.

We have granted a 45 day option to Rodman & Renshaw, LLC and Axiom Capital Management, Inc., the underwriters, to purchase up to an additional 819,750 shares of common stock from us on the same terms as set forth above. If the underwriters exercise their right to purchase all of such additional shares of common stock, such shares will be purchased at the public offering price less the underwriting discount. The shares issuable upon exercise of the underwriter option are identical to those offered by this prospectus and have been registered under the registration statement of which this prospectus forms a part.

The underwriters expect to deliver the shares of common stock to purchasers in the offering against payment in New York, New York on or about December 28, 2010.

Rodman & Renshaw, LLC **Axiom Capital Management, Inc.**

The date of this prospectus is December 21, 2010

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You should rely only on the information contained in this prospectus. Neither we nor the underwriters have authorized anyone to provide you with information different from that contained in this prospectus. We and the underwriters are offering to sell shares of common stock and seeking offers to buy shares of common stock only in jurisdictions where such offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common stock.

We own, have rights to or have applied for the trademarks and trade names that we use in conjunction with our business, including our logo. All other trademarks and trade names appearing in this prospectus are the property of their respective holders.

In this prospectus we rely on and refer to information and statistics regarding our industry. We obtained this market data from independent industry reports or other publicly available information. Some data is also based on our good faith estimates, which are derived from our review of internal surveys and studies, as well as independent industry reports.

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PROSPECTUS SUMMARY

The following summary highlights information contained in this prospectus and should be read in conjunction with the more detailed information contained in this prospectus and the consolidated financial statements and related notes appearing elsewhere in this prospectus. Before you decide to invest in our common stock, you should read the entire prospectus carefully, including the "Risk Factors" section in this prospectus.

Unless otherwise specified or required by the context, references to "we," "our," "us" and the "Company" refer collectively to Sino Clean Energy Inc., a Nevada corporation, and its subsidiaries (i) Wiscon Holdings Limited, a Hong Kong company ("Wiscon"), (ii) Tongchuan Suoke Clean Energy Co., Ltd., a PRC limited liability company ("Suoke Clean Energy"), (iii) Shaanxi Suo'ang New Energy Enterprise Co., Ltd., a PRC limited liability company ("Suo'ang New Energy"), and (iv) Shenyang Suo'ang Energy Co., Ltd., a PRC limited liability company ("Shenyang Energy").

For convenience, certain amounts in Chinese Renminbi ("RMB") have been converted to United States dollars. Assets and liabilities are converted at the exchange rate as of the balance sheet date. Income and expenses are converted at the average exchange rate for the period.

Unless the context requires otherwise or we specifically indicate otherwise, the information in this prospectus assumes that the underwriters do not exercise their over-allotment option. Unless otherwise indicated, all share and per share numbers in the prospectus have been retroactively adjusted to reflect a 1-for-10 reverse stock split of our common stock, which was effective on May 7, 2010.

Our Company

We produce and distribute coal-water slurry fuel ("CWSF") in the People's Republic of China (the "PRC" or "China"), which is a fuel substitute for oil, natural gas and coal briquettes. CWSF is a clean fuel that consists of fine coal particles suspended in water, and mixed with chemical additives. Our CWSF products are mainly used to fuel boilers and furnaces to generate steam and heat for both residential/commercial heating and industrial applications.

We operate our business through five production lines and currently have in place CWSF production capacity of 850,000 metric tons. The first production line commenced operations in July 2007 in Tongchuan, Shaanxi Province, with 100,000 metric tons of capacity. The second production line commenced operations in February 2009 in Tongchuan with 250,000 metric tons of capacity. The third and fourth production lines commenced operations in October 2009 in Shenyang, Liaoning Province, with the combined capacity of 300,000 metric tons. The fifth production line commenced operations in January 2010 in Tongchuan with 200,000 metric tons of capacity. In 2009, we sold approximately 456,000 metric tons of CWSF.

Our Industry

China's economic growth over the past four decades has led to a rapid increase in energy consumption. According to Frost & Sullivan, China accounted for 17.7% of global energy consumption in 2008 and according to the International Energy Agency, has overtaken the United States as the world's largest energy consumer. As the country's demand for energy has increased, China has relied heavily on its substantial coal reserves, which represent 94% of China's proven fossil fuel reserves. According to Frost & Sullivan, coal is expected to be used in approximately 67% of total energy production in China in 2010.

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Coal infrastructure is firmly established in China and coal, as a source of energy, is very well positioned relative to other energy sources due to its abundance, broad geographic distribution, low cost, and stable price. As such, the Chinese government is strongly focused on improving coal's environmental shortcomings, as opposed to replacing coal as an energy source. China continues to commit resources to clean energy and, according to China's Report on Central and Local Budgets, has budgeted approximately US$12 billion in 2010 for energy conservation and pollution reduction. CWSF has been listed as a key scientific and technological project in each of China's Five-Year Plans since 1981 and in several other major sustainable development policy initiatives.

According to Frost & Sullivan, market demand of CWSF in China reached 15.9 million metric tons in 2008, with approximately 59% of the demand being met by in-house producers, 28% by imports and only 13% by third-party producers such as us. Third party CWSF producers do not include entities that produce CWSF in-house for their own consumption or parties that import CWSF for sale. According to Frost & Sullivan, CWSF is used in fuel-burning furnaces in 700 industrial furnaces and hundreds of industrial kilns as a replacement for oil, natural gas and coal briquettes. According to Zhongjing Zongheng Economy Research, there are approximately 600,000 traditional fossil fuel burning industrial boilers and kilns currently installed in China, with approximately 100,000 requiring replacement or major repairs each year. The conversion of conventional fossil fuel boilers to CWSF boilers is expected to drive demand for CWSF, with Frost & Sullivan estimating a compound annual growth rate of 24.7% from 2008 to 2014. Although there are approximately 40 to 50 active CWSF suppliers in China, most have third party sales volumes of less than 100,000 metric tons, according to Frost & Sullivan. Markets for CWSF are highly regionalized given the high cost of transportation, with most suppliers typically targeting customers that are within 200 kilometers of their production facilities. As such, suppliers typically compete on a very localized level and lack the capability to expand to a more regional or national scale. Our track record for high quality products and service, our ability to expand selectively into new regions, and our strategic partnerships have enabled us to become the largest third-party CWSF producer in China, as measured by CWSF sales volumes for the first half of 2010.

Company Strengths

We believe the following strengths provide our company with significant competitive advantages in our industry:

Exclusive focus on CWSF, which has significant advantages over coal briquettes and other traditional fossil fuels. CWSF has several advantages over coal briquettes and other traditional fossil fuels, including:

- it is more energy efficient;
- it creates significantly less pollution;
- it is a cheaper source of energy;
- it is cleaner to transport and store; and
- it is safer to handle.

The CWSF industry is growing rapidly due to strong government support. Overall CWSF demand is expected to grow at a CAGR of 24.7% from 2008 to 2014 due to central and local government support for low carbon technologies and the conversion of older coal briquette burning boilers that are being phased out by legislation and obsolescence.

Dominant market position with a proven product and technology that is in full scale commercial production. We are the largest third-party CWSF producer in China, as measured by third party CWSF sales volume for the first half of 2010, and we currently have in-place production capacity of 850,000 metric tons. We aim to increase our production capacity to 1,850,000 metric tons through the expansion of production capacity at existing facilities and the development of new facilities throughout China. For the year ended December 31, 2009, we had revenue and income from operations of approximately US$46 million and US$14 million, respectively.

Agreements with Select Strategic Partners. We have entered into key agreements to supply CWSF in Shaanxi and Liaoning provinces:

- Exclusive sales agency agreement with Qingdao Haizhong Enterprise Co., Ltd. ("Haizhong Boiler"), a CWSF boiler vender with an estimated 78% share of the CWSF boiler market (according to Beijing Zhongjing Zhongheng Information and Consulting Center, Haizhong Boiler's market share was determined on December 30, 2009 and was valid until October 31, 2010), to distribute CWSF boilers in Xian and Tongchuan, Shaanxi Province, and an exclusive nationwide strategic partnership agreement with Haizhong Boiler to supply CWSF in the markets where it sells CWSF boilers and operates heat supply plants;

- Exclusive agreement with Shenyang Haizhong Heat Resource Co., Ltd. to supply CWSF for residential and commercial heating in Shenyang, Liaoning Province; and

- Agreement with Tongchuan City Investment and Development Co., Ltd. to develop and supply CWSF to 15 heat supply plants in Tongchuan, Shaanxi Province.

Established relationships with customers and suppliers which provide visibility on long term cash flows. As of September 30, 2010, our customer base was comprised of 43 residential heating and industrial users, most of which are subject to long term framework agreements. Since commencing commercial operations in 2007, we have achieved a 100% customer retention rate.

Experienced management team with a proven track record. We have a well seasoned and experienced senior management team with significant CWSF industry expertise that we believe will enable us to execute on our expansion strategy. Our management team has demonstrated the ability to rapidly increase production capacity.

Growth Strategy

Our objective is to become the leading CWSF provider in China. Key elements of our growth strategy include:

Pursue organic growth in existing markets. In 2009, we sold approximately 456,000 metric tons of CWSF, representing substantially all of our production in that year. We currently have annual production capacity of 850,000 metric tons of CWSF. We believe that there is significant organic growth potential within our current operations as we continue to bring new production capacity on-line in both of our existing markets.

Leverage our strategic partnership with Haizhong Boiler. We have established a nationwide strategic partnership agreement with Haizhong Boiler, which is the largest CWSF boiler vendor in China with an estimated 78% share of the CWSF boiler market. According to

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Beijing Zhongjing Zhongheng Information and Consulting Center, Haizhong Boiler's market share was determined on December 30, 2009 and was valid until October 31, 2010. We believe this strategic partnership will give us the ability to market our CWSF products to prospective customers more effectively in new and existing markets.

Capitalize on strong government support for CWSF. As China has low-cost, abundant and geographically distributed coal reserves and a mature coal-to-energy conversion infrastructure, it is expected that coal will continue to be one of the most important sources of energy for China in the foreseeable future. The Chinese government has listed CWSF as a key scientific and technological project in each of the Five-Year Plans since 1981. Many provincial and municipal governments across China have adopted plans, policies and incentives with specific and quantifiable targets to mandate or promote the usage of CWSF.

Grow through expansion and acquisitions in other regional markets. We plan to increase our CWSF production capacity through the construction of new facilities and the acquisition of existing CWSF production facilities in new geographic regions. We expect that such external growth initiatives will increase our aggregate annual CWSF production capacity to 1,850,000 metric tons. Our geographic expansion plans will initially focus on Guangxi Province and Guangdong Province.

Risk Factors

Our business is subject to numerous risks which are highlighted in the section entitled "Risk Factors" immediately following this prospectus summary. Principal risks of our business include:

Our limited operating history makes it difficult to evaluate our future prospects and results of operations.

The commercial success of CWSF depends on the degree of its market acceptance among industrial and residential customers, and if CWSF does not attain wide market acceptance, our operations and profitability could be adversely affected.

Competitors may develop and market products that are less expensive, more effective or safer, making CWSF obsolete or uncompetitive.

Existing regulations and changes to such regulations may present technical, regulatory and economic barriers to the purchase and use of CWSF, which may significantly affect the demand for our products.

The downturn in the global economy, or adverse changes in political and economic policies of the PRC government, could slow overall domestic economic growth of China, which could materially and adversely affect our business.

The failure to comply with PRC regulations relating to mergers and acquisitions of domestic enterprises by offshore special purpose vehicles may subject us to severe fines or penalties, and create other regulatory uncertainties regarding our corporate structure.

The market price for our stock may be volatile and our common stock is thinly traded, therefore you may be unable to sell at or near ask prices or at all if you need to sell your shares to raise money or otherwise desire to liquidate your shares.

If we require additional financing to execute our business plan, we may not be able to find such financing on satisfactory terms or at all, and financing involving the sale of additional

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common stock or other equity securities could result in additional dilution to our stockholders.

If we fail to develop and maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

Corporate History and Structure

Our current corporate structure is the result of a number of complex corporate restructurings through which we acquired control of our CWSF business in the PRC. We entered into this series of corporate restructurings in part because certain rules and regulations in the PRC restrict the ability of non-PRC companies that are controlled by PRC residents to acquire PRC companies.

On October 20, 2006, we acquired control of Hangson Limited, a British Virgin Islands company ("Hangson") pursuant to a Share Exchange Agreement, dated October 18, 2006 (the "Exchange Agreement"). Hangson was a holding company that controlled Shaanxi Suo'ang Biological Science & Technology Co., Ltd., a PRC company ("Suo'ang BST") and Suo'ang BST's 80%-owned subsidiary at the time, Suo'ang New Energy, through a series of contractual arrangements. Sou'ang BST, through Suo'ang New Energy, commenced CWSF production in July 2007.

As part of a process to ultimately directly control 100% ownership of Suo'ang New Energy, we began to reorganize our corporate structure in June 2009. In June 2009, we acquired 100% of Wiscon, which established Suoke Clean Energy, the Company's wholly foreign owned enterprise, in Tongchuan, Shaanxi Province. We subsequently entered into a series of agreements transferring all of the rights and obligations of Hangson under the contractual arrangements with Suo'ang BST to Suoke Clean Energy.

On November 12, 2009, Suo'ang New Energy received a new business license from the Tongchuan Administration for Industry and Commerce, which reflected that the acquisition of 100% of the equity of Suo'ang New Energy by Suoke Clean Energy had been completed. As a result, our CWSF business is now conducted primarily through Suo'ang New Energy, which is a 100% wholly owned subsidiary of Suoke Clean Energy, under applicable PRC laws and we are now able to directly control Suo'ang New Energy through our 100% ownership of Suoke Clean Energy. On May 14, 2010, Suoke Clean Energy's acquisition of Suo'ang New Energy was recorded with the Tongchuan Bureau of Commerce.

On October 12, 2009, Suo'ang New Energy established a wholly-owned subsidiary, Shenyang Energy, to conduct business in Shenyang, Liaoning Province.

On December 31, 2009, Suoke Clean Energy terminated all of its contractual arrangements with Suo'ang BST. In connection with this termination, certain assets held by Suo'ang BST, such as office equipment, vehicles, bank deposits and accounts receivable, were transferred to Suoke Clean Energy. Employees of Suo'ang BST signed new employment contracts with Suoke Clean Energy and rights and obligations under certain remaining business operation agreements, and research and development contracts between Suo'ang BST and third parties, were assigned to Suo'ang New Energy. Hangson transferred all of its equity interests in Wiscon to us.

Although the equity transfers in the PRC described above were approved by local governmental agencies, they were not approved by the PRC Ministry of Commerce ("MOFCOM") or the China Securities and Regulatory Commission (the "CSRC"). For a discussion of the risks and uncertainties

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arising from these PRC rules and regulations, see "Risk Factors The failure to comply with PRC regulations relating to mergers and acquisitions of domestic enterprises by offshore special purpose vehicles may subject us to severe fines or penalties, and create other regulatory uncertainties regarding our corporate structure." For a more detailed description of our corporate history and structure, see "Management's Discussion and Analysis of Financial Condition and Results of Operation Corporate Organization and History."

The following chart shows our current corporate structure:

Corporate Information

Our executive offices are located at Room 1502, Building D, Wangzuo International City Building No. 3 Tangyuan Road, Gaoxin District Xi'an, Shaanxi Province, P.R.C. and our telephone number is: (011) 86-29-8844-7960. Our corporate website is *www.sinocei.com*. Information contained on or accessed through our website is not intended to constitute and shall not be deemed to constitute part of this prospectus.

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The Offering

Common stock we are offering	5,465,000 shares
Over-allotment option	819,750 shares
Common stock to be outstanding after this offering	22,257,239 shares (or 23,076,989 if the over-allotment is exercised in full)
Use of proceeds	We estimate that the net proceeds to us from this offering will be approximately $25,575,000 based on the offering price of $5.25 per share and after deducting the underwriting discounts and estimated offering expenses payable by us. We intend to use the net proceeds from this offering to expand our CWSF production capacity at new and existing facilities. We intend to use any remaining net proceeds for working capital and general corporate purposes. See "Use of Proceeds" on page 33.
NASDAQ Global Market symbol	"SCEI"
Risk factors	Investing in our common stock involves a high degree of risk. Please see the section entitled "Risk Factors" starting on page 10 of this prospectus to read about risks that you should consider carefully before buying shares of our common stock.

Unless otherwise indicated, the number of shares of our common stock to be outstanding after this offering is based on 16,792,239 shares of our common stock outstanding as of September 30, 2010 and excludes:

- 3,633,535 shares of our common stock issuable upon exercise of warrants with a weighted average exercise price of $2.56 per share; and
- 65,000 shares of our common stock issuable upon exercise of options with a weighted average exercise price of $7.25 per share.

Unless otherwise indicated, the share information in this prospectus is as of September 30, 2010 and reflects or assumes:

- our 1-for-10 reverse stock split that we effected on May 7, 2010; and
- the underwriters do not exercise their over-allotment option to purchase up to an additional 819,750 shares of our common stock from us.

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Summary Consolidated Financial Information

The following tables present our summary consolidated financial information for the periods indicated and should be read in conjunction with the information contained in "Selected Consolidated Financial Information," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes appearing elsewhere in this prospectus. Historical operating information may not be indicative of our future performance. The consolidated financial statements are reported in United States dollar amounts and have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP"). The consolidated financial statements for the years ending December 31, 2009 and 2008 have been audited by Weinberg & Company, P.A., an independent registered public accounting firm.

	Nine Months Ended September 30,		Year Ended December 31,	
	2010 (unaudited)	2009 (unaudited)	2009	2008
Income Statement Data:				
Revenue	$ 73,571,899	$ 26,982,573	$ 46,012,353	$ 14,253,989
Cost of goods sold	(44,448,913)	(17,695,505)	(28,922,846)	(9,266,832)
Gross profit	29,122,986	9,287,068	17,089,507	4,987,157
Selling expenses	3,203,245	422,405	1,125,884	13,128
General and administrative expenses	1,925,072	1,452,975	1,796,032	554,766
Income from operations	23,994,669	7,411,688	14,167,591	4,419,263
Other income (expense), net	15,658,614	(35,163,733)	(46,749,191)	(962,560)
Income (loss) before income taxes and non-controlling interest	39,653,283	(27,752,045)	(32,581,600)	3,456,703
Provision for income taxes	4,640,556	1,055,718	2,243,088	105,249
Net income (loss)	35,012,727	(28,807,763)	(34,824,688)	3,351,454
Net income allocable to non-controlling interest				(351,849)
Net income (loss) allocable to Sino Clean Energy Inc.	$ 35,012,727	$ (28,807,763)	$ (34,824,688)	$ 2,999,605
Basic earnings (loss) per share	$ 2.28	$ (3.00)	$ (3.56)	$ 0.34
Diluted earnings (loss) per share	$ 1.88	$ (3.00)	$ (3.56)	$ 0.34
Basic weighted average shares outstanding	15,385,062	9,609,130	9,792,922	8,716,962
Diluted weighted average shares outstanding	18,668,856	9,609,130	9,792,922	8,816,208

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Reconciliation of Net Income (Loss) to Unaudited Non-GAAP Adjusted Earnings

The following table includes a reconciliation of our Net Income (Loss) to unaudited non-GAAP Adjusted Earnings for the nine months ended September 30, 2010 and 2009 and for the years ended December 31, 2009 and 2008:

	For Nine Months Ended September 30,		For Years Ended December 31,	
	2010 (unaudited)	2009 (unaudited)	2009	2008
Net income (loss)	$ 35,012,727	$ (28,807,763)	$ (34,824,688)	$ 2,999,605
Amortization of discount on convertible notes	8,601,975	3,873,979	3,942,185	
Value of shares issued for bonus interest	1,864,701			
Expenses related to escrow shares		1,294,881	11,125,071	676,466
Gain on extinguishment of derivative liabilities	(28,404,181)	(3,370,593)	(7,046,556)	
Change in fair value of derivative liabilities	2,348,479	8,236,238	12,770,113	
Cost of private placement		24,794,842	24,977,114	
Non-GAAP Adjusted earnings (unaudited)	$ 19,423,701	$ 6,021,584	$ 10,943,239	$ 3,676,071
Non-GAAP Adjusted earnings per share basic (unaudited)	$ 1.02	$ 0.30	$ 0.57	$ 0.36
Non-GAAP Adjusted earnings per share diluted (unaudited)	$ 1.02	$ 0.30	$ 0.57	$ 0.36
Reconciliation of GAAP basic shares outstanding to Non-GAAP basic shares outstanding				
GAAP Basic Shares outstanding	15,385,062	9,609,130	9,792,922	8,716,962
Assumed conversion of convertible debentures		6,101,053	5,377,368	890,433
Assumed exercise of warrants	3,633,534	4,116,614	4,116,614	639,013
Non-GAAP Basic Shares outstanding	19,018,596	19,826,797	19,286,904	10,246,408
Reconciliation of GAAP diluted shares outstanding to Non-GAAP diluted shares outstanding				
GAAP Diluted shares outstanding	18,668,856	9,609,130	9,792,922	8,816,208
Assumed conversion of convertible debentures		6,101,053	5,377,368	890,433
Assumed exercise of warrants	349,740	4,116,614	4,116,614	539,767
Non-GAAP Diluted shares outstanding	19,018,596	19,826,797	19,286,904	10,246,408

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Non-GAAP Financial Measure

Non-GAAP adjusted earnings and non-GAAP adjusted earnings per share are not measures of financial performance under U.S. GAAP, and should not be considered in isolation or as an alternative to net income (loss) and earnings per share. We define non-GAAP adjusted earnings as net income (loss) excluding charges for the change in derivatives, gains on the extinguishment of derivatives, cost of private placements, which represents the excess of the fair value of the derivative liability created upon issuance of the notes over the amounts received, shares issued for bonus interest, expenses related to escrow shares, and other non-cash financing costs. We believe non-GAAP adjusted earnings is an important measure of operating performance because it allows management, securities analysts, investors and others to evaluate and compare our core operating results to other companies in our industry, including our return on capital and operating efficiencies, from period to period by removing the impact of our costs of private placements, derivative liabilities and other non-cash financing costs. Non-GAAP basic and diluted shares reflects the potential dilution that could occur if convertible debentures and warrants that represent derivatives and note discount were exercised or converted into common stock. Other companies may calculate non-GAAP adjusted earnings differently, and therefore our non-GAAP adjusted earnings and non-GAAP adjusted earnings per share may not be comparable to similarly titled measures of other companies.

	As of September 30, 2010		As of December 31,	
	Actual (unaudited)	As Adjusted(1) (unaudited)	2009	2008
Balance Sheet Data:				
Cash and cash equivalents	$ 34,348,096	$ 59,923,096	$ 18,302,558	$ 3,914,306
Working capital	20,173,642	45,748,642	7,730,396	5,716,968
Total assets	66,239,056	91,114,056	44,633,779	21,105,793
Derivative liabilities	19,101,337	19,101,337	45,157,039	
Total liabilities	24,959,466	24,259,466	51,094,990	2,159,441
Stockholders' equity	41,279,590	66,854,590	(6,461,211)	18,946,352
Total liabilities and stockholders' equity	66,239,056	91,114,056	44,633,779	21,105,793

(1) Reflects the results of the sale by us of 5,465,000 shares of common stock in this offering at the public offering price of $5.25 per share and our receipt of approximately $25,575,000 of the estimated net proceeds of the offering, after deducting underwriting discounts and estimated offering expenses payable by us.

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RISK FACTORS

Any investment in our common stock involves a high degree of risk. You should consider carefully the specific risk factors described below in addition to the other information contained in this prospectus, including our consolidated financial statements and related notes included elsewhere in the prospectus, before making a decision to invest in our common stock. If any of these risks actually occurs, our business, financial condition, results of operations or prospects could be materially and adversely affected. This could cause the trading price of our common stock to decline and a loss of all or part of your investment.

Risks Associated With Our Business

Our limited operating history makes it difficult to evaluate our future prospects and results of operations.

We have a relatively limited operating history. We commenced operations of our CWSF business in 2007. Accordingly, you should consider our future prospects in light of the risks and uncertainties experienced by early stage companies in evolving industries such as the coal products and alternative energy industries in China. Our limited history for producing CWSF may not serve as an adequate basis to judge our future prospects and results of operations. Our operations are subject to all of the risks, challenges, complications and delays frequently encountered in connection with the operation of any new business, as well as those risks that are specific to the CWSF industry. Investors should evaluate us in light of the problems and uncertainties frequently encountered by companies attempting to develop markets for new products and technologies. Despite our best efforts, we may never overcome these obstacles.

If we require additional financing to execute our business plan, we may not be able to find such financing on satisfactory terms or at all.

Income generated from our business may not be adequate to support the expansion of our business. We may still need substantial additional funds to build new production facilities, maintain and expand existing facilities, pursue research and development activities, obtain necessary regulatory approvals and market our business. While we may seek additional funds through public or private equity or debt financing, strategic transactions and/or from other sources, there are no assurances that future funding will be available on favorable terms or at all. If additional funding is not obtained, we may need to reduce, defer or cancel any planned expansion, including overhead expenditures, to the extent necessary. Furthermore, the failure to fund our capital requirements as they arise would have a material adverse effect on our business, financial condition and results of operations.

Our business and results of operations are dependent on the PRC coal markets, which may be cyclical.

As our revenue is substantially derived from the sale of CWSF, our business and operating results are substantially dependent on the domestic supply of coal, especially washed coal. The PRC coal market is cyclical and exhibits fluctuation in supply and demand from year to year and is subject to numerous factors beyond our control, including, but not limited to, economic conditions in the PRC, global economic conditions, and fluctuations in industries with high demand for coal, such as the utilities and steel industries. Fluctuations in supply and demand for coal affects coal prices which, in turn, may have an adverse effect on our operating and financial performance. The demand for coal is primarily affected by overall economic development and the demand for coal from the electricity generation, steel and construction industries. The supply of coal, on the other hand, is primarily affected by the geographic location of the coal supplies, the volume of coal produced by domestic and international coal suppliers, and the quality and price of competing sources of coal. Alternative fuels such as natural gas and oil, alternative energy sources such as hydroelectric power and nuclear power, and international shipping costs also impact the market demand for coal. Excess demand for coal may increase coal prices, which would have an adverse effect on our cost of goods sold which would, in turn, cause a short-term decline in our profitability if we are unable to increase the price of our CWSF to our customers.

The consumption of CWSF is seasonal in nature, and we may experience fluctuation in our sales of CWSF over the course of the year.

The demand for CWSF from residential heating customers tends to be seasonal in nature, with peak demand occurring between the months of October through March, which are the peak heating periods in the markets which the Company currently serves. Demand for CWSF during peak periods is approximately 30% to 40% higher than during non-peak periods. Demand for CWSF from industrial customers tends to be fairly stable throughout the year, as their application of CWSF is often unrelated to heating. We may experience fluctuations in our sales of CWSF over the course of the year if the demand for CWSF from residential heating customers decreases due to unexpected warmer temperatures during the winter months.

We place significant reliance on one major supplier and the loss of such supplier could have a material adverse effect on our operations.

We are dependent upon our relationships with local third parties for our supply of coal. Five suppliers provided 100% of the coal we used to produce CWSF in 2008 and 2009 and our single largest supplier provided 85%, and 87%, respectively. While we expect to increase the number of suppliers we use as our business expands, if any of these suppliers, and in particular our largest supplier, terminate their supply relationship with us, we may be unable to procure sufficient amounts of coal to fulfill our demand. If we are unable to obtain adequate quantities of coal to meet the demand for our CWSF product, our customers could seek to purchase products from other suppliers, which could have a material adverse effect on our revenue.

In the past, we have derived a significant portion of our sales from a few large customers. If we were to lose any such customers, our business, operating results and financial condition could be materially and adversely affected.

Historically, our customer base has been highly concentrated. As of September 30, 2010 we had a total of 43 customers, 38 of which were located in Shaanxi Province, and 5 of which were located in Liaoning Province. In 2008 and 2009, our five largest customers contributed 57% and 37% of our total revenue, respectively, while our largest customer contributed 14% and 14% of our total revenue, respectively. Our customers are still relatively concentrated, and any adverse developments to any one of their business operations and demand for CWSF could have an adverse impact on our business, operating results and financial condition.

Our business and prospects will be adversely affected if we are not able to compete effectively.

We face competition in all areas of our business. While we have no direct competitor for CWSF in our largest market in Shaanxi Province, there are other CWSF producers in other areas of China that may look to expand their business into our markets. Additionally, we must compete against producers of other forms of energy such as coal, natural gas and oil, which may have broader market acceptance. We expect to enter the South China market in Guangdong Province and Nanning City located in Guangxi Province. We may be required to compete with other CWSF producers operating in these regions who may have greater financial, marketing, distribution and technological resources than we have, and more well-known brand names in the marketplace. If we are unable to compete

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effectively against our competitors, it may have a material adverse impact on our expansion plans and on our results of operations.

We depend on our key executives, and our business and growth may be severely disrupted if we lose their services.

Our future success depends substantially on the continued services of our key executives. In particular, we are highly dependent upon Mr. Baowen Ren, our chairman and chief executive officer, who has established relationships within the CWSF industry, Mr. Peng Zhou, a member of our board of directors, and Ms. Wen (Wendy) Fu, our chief financial officer. If we lose the services of these executives, we may not be able to replace them readily, if at all, with suitable or qualified candidates, and may incur additional expenses to recruit and retain qualified candidates with industry experience similar to our current key executives, which could severely disrupt our business and growth. In addition, if any of our key executives joins a competitor or forms a competing company, we may lose some of our suppliers or customers. Furthermore, as we expect to continue to expand our operations and develop new products, we will need to continue attracting and retaining experienced management and key research and development personnel.

We face competition from other companies, universities, public and private research institutions, government entities and other organizations. Competition for qualified candidates for executive positions could cause us to offer higher compensation and other benefits in order to attract and retain them, which could have a material adverse effect on our financial condition and results of operations. We may also be unable to attract or retain the personnel necessary to achieve our business objectives, and any failure in this regard could severely disrupt our business and growth.

Our business will suffer if we cannot obtain, maintain or renew necessary licenses.

All PRC enterprises in the coal trading industry are required to obtain from various PRC governmental authorities certain licenses, including, without limitation, a Certificate of Coal Business and a business license. On July 5, 2010, we received the Certificate of Coal Business for Suo'ang New Energy, and on July 15, 2010, we received the Certificate of Coal Business for Shenyang Energy, both of which expire in 2013. Any failure to timely renew the required Certificates of Coal Business prior to expiration may subject us to various penalties, such as fines up to five times the illegal profits, confiscation of profits, or we may be required to cease our business operations.

These licenses are subject to periodic renewal and/or reassessment by the relevant PRC government authorities and the standards of compliance required in relation thereto may from time to time be subject to change. We have such permits and licenses, however, we cannot be certain that we can obtain, maintain or renew the permits and licenses or in the future, accomplish the reassessment of such permits and licenses in a timely manner. Any changes in compliance standards, or any new laws or regulations may prohibit or render it more restrictive for us to conduct our business or increase our compliance costs, which may adversely affect our operations or profitability. Any failure by us to obtain, maintain or renew the licenses, permits and approvals, may have a material adverse effect on the operation of our business. In addition, we may not be able to carry on business without such permits and licenses being obtained, renewed and/or reassessed.

We may suffer losses resulting from industry-related accidents and lack of insurance.

Our manufacturing facilities may be affected by water, gas, fire or structural problems. As a result, we, like other coal-based products companies, may experience accidents that could cause property damage and personal injuries. Although we have implemented safety measures for our

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production facilities and provided on-the-job training for our employees, there can be no assurance that accidents will not occur in the future. Additionally, the risk of accidental contamination or injury from handling and disposing of our product cannot be completely eliminated. In the event of an accident, we could be held liable for resulting damages.

Although we currently maintain fire, casualty and property insurance covering our two production lines in Shenyang and three production lines in Tongchuan, we do not maintain any business interruption insurance or any third party liability insurance to cover claims related to personal injury, property or environmental damage arising from accidents on our properties, other than third party liability insurance with respect to vehicles. Any uninsured losses and liabilities incurred by us could exceed our resources and have a material adverse effect on our financial condition and results of operations.

Competitors may develop and market products that are less expensive, more effective or safer, making CWSF obsolete or uncompetitive.

Some of our competitors and potential competitors may have greater product development capabilities and financial, scientific, marketing and human resources than we do. Technological competition from other alternative energy companies is intense and is expected to increase. Other companies have developed technologies that could be the basis for competitive products. Some of these products may be more effective and less costly than CWSF. Over time, CWSF may become obsolete or uncompetitive, which would have a material adverse effect on our business and results of operations.

The revenue of our business may be adversely effected if power generators switch to sources of fuel with lower carbon dioxide emissions.

China is a signatory to the 1992 United Nations Framework Convention on Climate Change and the 1997 Kyoto Protocol, which are intended to limit emissions of greenhouse gases. Efforts to control greenhouse gas emission in China could result in reduced use of coal if power generators switch to sources of fuel with lower carbon dioxide emissions, which in turn could reduce the revenue of our business and have a material adverse effect on our results of operations.

The commercial success of CWSF depends on the degree of its market acceptance among industrial and residential heating customers and if CWSF does not attain wide market acceptance, our operations and profitability could be adversely affected.

Despite the central government's push for clean-coal technology and the support for CWSF amongst a number of municipal governments, CWSF ultimately may not gain wide market acceptance in the PRC. The degree of market acceptance of any product depends on a number of factors, including establishment and demonstration of its efficacy and safety, cost-effectiveness, advantages over alternative products, and marketing and distribution support for the product. Currently, there is limited information regarding these factors in connection with CWSF or competitive products. We believe that our customers need to continue to purchase and install CWSF boilers in order to give us the ability to market our CWSF products more broadly.

The market for CWSF is emerging and rapidly evolving, and its future success remains uncertain. If CWSF is not suitable for widespread adoption or sufficient demand for CWSF does not develop or takes longer to develop than we anticipate, our sales would not significantly increase and we may be unable to sustain profitability. In addition, demand for CWSF in the markets and geographic regions

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where we operate may not develop or may develop more slowly than we anticipate. Many factors will influence the widespread adoption of CWSF and demand for our products, including:

- cost-effectiveness of CWSF as compared with conventional and other alternative energy products and technologies;
- performance and reliability of CWSF as compared with conventional and other alternative energy products and technologies;
- fluctuations in capital expenditures by customers in the installation of CWSF boilers; and
- availability of government subsidies and incentives for customers.

Furthermore, to establish wide market acceptance of CWSF, we will require a marketing and sales force with appropriate technical expertise and supporting distribution capabilities, as well as continuing governmental support for the use of CWSF. We may not be able to establish sales, marketing and distribution capabilities or enter into arrangements with third parties on acceptable terms, and our ability to influence governmental support is limited. If CWSF does not gain wide market acceptance, our ability to continue to grow may be limited.

If we were unsuccessful in defending a product liability claim, we could face substantial liabilities that may exceed our resources.

We may be held liable if our product causes injury or is found unsuitable during product testing, manufacturing, marketing, sale or use. We currently do not have product liability insurance. If we choose to obtain product liability insurance but cannot obtain sufficient coverage at an acceptable cost or otherwise protect against potential product liability claims, the commercialization of our product may be prevented or inhibited. If we are sued for any injury caused by our product, our liability could exceed our total assets. In addition, successful product liability claims against us may materially disrupt the conduct of our business.

The downturn in the global economy may slow domestic growth in China, which, in turn, may affect our business.

China may not be able to maintain its recent growth rates mainly due to the decreased demand for China's exported goods in countries experiencing recessions. As we do not presently export any of our products, our earnings may become unstable if China's domestic growth slows significantly and the domestic demand for energy declines.

We are exposed to various types of market risks, including changes in foreign exchange rates, commodity prices and inflation in the normal course of business.

We are subject to risks resulting from fluctuations in interest rates on our bank balances. A substantial portion of our cash is held in China in interest bearing bank deposits and is denominated in RMB. To the extent that we may need to raise debt financing in the future, upward fluctuations in interest rates will increase the cost of new debt. We do not currently use any derivative instruments to manage our interest rate risk.

Certain raw materials used by us are subject to price volatility caused by supply conditions, political and economic variables and other unpredictable factors. The primary purpose of our commodity price management activities is to manage the volatility associated with purchases of commodities in the normal course of business. We do not speculate on commodity prices. We are primarily exposed to price risk related to our purchase of coal used in manufacturing products. We

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purchase most of our raw materials at prevailing market prices. We do not have formal long-term purchase contracts with our suppliers and, therefore, we are exposed to the risk of fluctuating raw material prices. Our raw material price risk increases in the short term if we are unable to increase the price of CWSF. We did not have any commodity price derivatives or hedging arrangements outstanding at September 30, 2010.

We carry out all of our transactions in Renminbi. Therefore, we have limited exposure to foreign exchange fluctuations. A substantial portion of our cash is held in China in interest bearing bank deposits and is denominated in RMB. The Renminbi is not a freely convertible currency. The PRC government may take actions that could cause future exchange rates to vary significantly from current or historical exchange rates. Fluctuations in exchange rates may adversely affect the value of any dividends we declare.

In recent years, China has not experienced significant inflation or deflation and thus inflation and deflation have not had a significant effect on our business during the past three years. According to the National Bureau of Statistics of China, the inflation rate as measured by the consumer price index in China was 4.8% and 5.9% in 2007 and 2008, respectively.

We were late in filing tax returns and information reports as required under U.S. laws, and may ultimately be held liable for significant taxes, interest and penalties.

We were late in filing our (1) U.S. federal income tax returns for our taxable years ended September 30, 2007 and 2008, including, without limitation, information returns on Internal Revenue Service ("IRS") Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, and (2) information reports for the years ended December 31, 2006, 2007 and 2008 concerning our interests in foreign bank accounts on TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBARs"). Late filings of the IRS Forms 5471 subjects us to civil penalties of $10,000 for each of our three foreign subsidiaries with respect to each of the taxable years at issue (for an aggregate of $60,000). In addition, we are subject to civil penalties for the untimely filing of the FBARs of at least $10,000 for each of our five foreign bank accounts over the three year period at issue (for an aggregate of $50,000). Although we do not believe that our failure to timely file the FBARs was "willful," if the IRS were to prove that our failure to file an FBAR was "willful," we ultimately could be held liable for a civil penalty for each such failure equal to the greater of $100,000 or 50% of the balance in the unreported foreign bank account. During the years at issue, our total foreign bank account balances have been as high as about $5.8 million. We have provided an accrual for what we believe would be the potential liabilities for the untimely filing of the IRS Forms 5471 and the FBARs in our financial statements for our year ended December 31, 2009. However, as indicated above, these potential liabilities could be substantially greater than the amounts we have accrued.

In addition, because we did not generate any income in the United States or otherwise have any U.S. taxable income, we do not believe that we owe U.S. federal income taxes for the taxable years ended September 30, 2007 and 2008, or in respect to any transactions that we or any of our subsidiaries may have engaged in through our financial year end December 31, 2009. However, there can be no assurance that the IRS will agree with this position, and therefore we ultimately could be held liable for U.S. federal income taxes, interest and penalties.

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Risks Related to the Alternative Energy Industry

A drop in the retail price of conventional energy or other alternative energy may have a negative effect on our business.

A customer's decision to purchase CWSF will be primarily driven by the return on investment resulting from the energy savings from CWSF over time. Any fluctuations in economic and market conditions that impact the viability of conventional and other alternative energy sources, such as decreases in the prices of oil and other fossil fuels could cause the demand for CWSF to decline and have a material adverse effect on our business and results of operations. Although we believe that current levels of retail energy prices support a reasonable return on investment for CWSF, there can be no assurance that future retail pricing of conventional energy and other alternative energies will remain at such levels.

Existing regulations and changes to such regulations may present technical, regulatory and economic barriers to the purchase and use of CWSF, which may significantly affect the demand for our products.

CWSF is subject to oversight and regulations in accordance with national and local ordinances and regulations relating to safety, environmental protection, and related matters. We are responsible for knowing such ordinances and regulations, and must comply with these varying standards. Any new government regulations or utility policies pertaining to our product may result in significant additional expenses to us and our customers and, as a result, could cause a significant reduction in demand for our product.

Risks Related to Doing Business in China

Our business operations are conducted entirely in the PRC. Because China's economy and its laws, regulations and policies are different from those typically found in western countries and are continually changing, we face risks specific to operating in China, including those summarized below.

Adverse changes in political and economic policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could materially and adversely affect our business.

All of our operations are conducted in China and all of our sales are made in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The PRC economy differs from the economies of most western countries in many respects, including:

- the amount of government involvement;
- the level of development;
- the growth rate;
- the control of foreign exchange; and
- the government's role in allocating resources.

While the PRC economy has grown significantly since the late 1970s, the growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us.

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The PRC economy has been transitioning from a planned economy to a more market-oriented economy and is expected to continue to reform its economic system. Many of the reforms are unprecedented or experimental, and are expected to be refined and improved. Although the PRC government has in recent years implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of the productive assets in China is still owned by the PRC government. The continued control of these assets and other aspects of the national economy by the PRC government could materially and adversely affect our business. The PRC government also exercises significant control over economic growth in China through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Efforts by the PRC government to slow the pace of growth of the PRC economy could result in decreased capital expenditure by energy users, which in turn could reduce demand for our products.

Other political, economic and social factors can also lead to further readjustment of reform measures, which may not always have a positive effect on our operations. Any adverse change in the economic conditions or government policies in China, such as changes in laws and regulations (or the interpretation thereof), imposition of additional restrictions on currency conversion could have a material adverse effect on the overall economic growth and the level of energy investments and expenditures in China, which in turn could lead to a reduction in demand for our products and consequently have a material adverse effect on our business and prospects.

The PRC economic cycle may negatively impact our operating results.

The rapid growth of the PRC economy before 2008 generally led to higher levels of inflation. The PRC economy has more recently experienced a slowing of its growth rate. A number of factors have contributed to this slow-down, including appreciation of RMB, the currency of China, which has adversely affected China's exports. In addition, the slow-down has been exacerbated by the recent global crisis in the financial services and credit markets, which has resulted in significant volatility and dislocation in the global capital markets. It is uncertain how long the global crisis in the financial services and credit markets will continue and the significance of the adverse impact it may have on the global economy in general, or the Chinese economy in particular. Slowing economic growth in China could result in slowing growth and demand for our products which could reduce our revenue. In the event of a recovery in the PRC, renewed high growth levels may again lead to inflation. Government attempts to control inflation may adversely affect the business climate and growth of private enterprise. In addition, our profitability may be adversely affected if prices for our products rise at a rate that is insufficient to compensate for the rise in inflation.

Uncertainties with respect to the PRC legal system could adversely affect us.

Our operations in China are governed by PRC laws and regulations. The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, many new laws and regulations covering general economic matters have been promulgated in the PRC. However, China has not developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. Even where adequate law exists, enforcement of existing laws or contracts based on existing law may be uncertain and sporadic, and it may be difficult to obtain swift and equitable enforcement or to obtain enforcement of a judgment by a court of another jurisdiction. The relative inexperience of the PRC's judiciary in many cases creates additional uncertainty as to the outcome of any litigation, and interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes. In addition, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of any such policies and rules until some time after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

The application of PRC laws regarding the regulation of monopolies may adversely affect us.

We have a nationwide strategic partnership agreement with Qingdao Haizhong Enterprise Co., Ltd. ("Haizhong Boiler"), a CWSF boiler manufacturer with an estimated 78% share of the national CWSF boiler market. According to Beijing Zhongjing Zhongheng Information and Consulting Center, Haizhong Boiler's market share was determined on December 30, 2009 and was valid until October 31, 2010. In accordance with this partnership agreement, we and Haizhong Boiler have each agreed to recommend to our respective customers the other party's products during the course of selling our own products. Under the PRC Anti-monopoly Law promulgated on August 30, 2007 and effective as of August 1, 2008, business operators with a dominant market position are prohibited from certain behavior that abuses their dominant market position, including among other things, (i) limiting another party to the transaction to trade exclusively with them or with their designated business operators without justification and (ii) implementing tie-in sales without justification, or imposing other supplementary unreasonable trading conditions in the transaction. If our strategic partnership agreement with Haizhong Boiler or the implementation of such agreement is deemed a violation of the anti-monopoly law, the anti-monopoly administration authority may order us to cease the conduct, confiscate our proceeds and impose a fine of 1% to 10% of the sales volume for the previous year. As a result, our business, results of operation and financial condition could be adversely affected.

The failure to comply with PRC regulations relating to mergers and acquisitions of domestic enterprises by offshore special purpose vehicles may subject us to severe fines or penalties and create other regulatory uncertainties regarding our corporate structure.

On August 8, 2006, the PRC Ministry of Commerce ("MOFCOM"), joined by the China Securities Regulatory Commission (the "CSRC"), the State-owned Assets Supervision and Administration Commission of the State Council (the "SASAC"), the State Administration of Taxation (the "SAT"), the State Administration for Industry and Commerce (the "SAIC"), and the State Administration of Foreign Exchange ("SAFE"), jointly promulgated regulations entitled the Provisions Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the "M&A Rules"), which took effect as of September 8, 2006. This regulation, among other things, has certain provisions that require offshore special purpose vehicles ("SPVs") formed for the purpose of acquiring PRC domestic companies and controlled by PRC individuals, to obtain the approval of MOFCOM prior to engaging in such acquisitions and to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock market. On September 21, 2006, the CSRC published on its official website a notice specifying the documents and materials that are required to be submitted for obtaining CSRC approval.

The application of the M&A Rules with respect to our corporate structure and to this offering remains unclear, with no current consensus existing among leading PRC law firms regarding the scope and applicability of the M&A Rules. We believe that the MOFCOM and CSRC approvals under the

M&A Rules were not required in the context of our share exchange transaction because at such time the share exchange was a foreign related transaction governed by foreign laws, not subject to the jurisdiction of PRC laws and regulations. However, we cannot be certain that the relevant PRC government agencies, including the CSRC and MOFCOM, would reach the same conclusion, and we cannot be certain that MOFCOM or the CSRC may deem that the transactions effected by the share exchange circumvented the M&A Rules, and other rules and notices, and that prior MOFCOM or CSRC approval is required for this offering. Further, we cannot rule out the possibility that the relevant PRC government agencies, including MOFCOM, would deem that the M&A Rules required us or our entities in China to obtain approval from MOFCOM or other PRC regulatory agencies in connection with (i) the equity transfer agreements, which were completed by and among Suoke Clean Energy, Peng Zhou and Suo'ang BST in November 2009, pursuant to which Suo'ang New Energy was acquired by Suoke Clean Energy and (ii) Hangson's control of Suo'ang New Energy during the period from June 2006 to September 2009 through contractual arrangements with Suo'ang BST and Peng Zhou's holding of a 20% equity interest in Suo'ang New Energy.

If the CSRC, MOFCOM, or another PRC regulatory agency subsequently determines that CSRC, MOFCOM or other approval was required for the share exchange transaction and/ or the acquisition of Suo'ang New Energy, or if prior CSRC approval for this offering is required and not obtained, we may face severe regulatory actions or other sanctions from MOFCOM, the CSRC or other PRC regulatory agencies. In such event, these regulatory agencies may impose fines or other penalties on our operations in the PRC, limit our operating privileges in the PRC, delay or restrict the repatriation of the proceeds from this offering into the PRC, restrict or prohibit payment or remittance of dividends to us or take other actions that could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our common stock. The CSRC or other PRC regulatory agencies may also take actions requiring us, or making it advisable for us, to delay or cancel this offering, to restructure our current corporate structure, or to seek regulatory approvals that may be difficult or costly to obtain.

The M&A Rules, along with certain foreign exchange regulations discussed below, will be interpreted or implemented by the relevant government authorities in connection with our future offshore financings or acquisitions, and we cannot predict how they will affect our acquisition strategy. For example, our operating companies' ability to remit dividends to us, or to engage in foreign-currency-denominated borrowings, may be conditioned upon compliance with the SAFE registration requirements by such Chinese domestic residents, over whom we may have no control.

SAFE regulations relating to offshore investment activities by PRC residents may increase our administrative burdens and restrict our overseas and cross-border investment activity. If our shareholders and beneficial owners who are PRC residents fail to make any required applications, registrations and filings under such regulations, we may be unable to distribute profits and may become subject to liability under PRC laws.

SAFE has promulgated several regulations, including Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Inbound Investment via Oversea Special Purpose Vehicles, or "Circular No. 75," issued on October 21, 2005 and effective as of November 1, 2005 and certain implementation rules issued in recent years, requiring registrations with, and approvals from, PRC government authorities in connection with direct or indirect offshore investment activities by PRC residents and PRC corporate entities. These regulations apply to our shareholders and beneficial owners who are PRC residents, and may affect any offshore acquisitions that we make in the future.

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SAFE Circular No. 75 requires PRC residents to register with the local SAFE branch before establishing or controlling any company outside of China for the purpose of capital financing with assets or equities of PRC companies, referred to in the notice as an "offshore special purpose company." In addition, any PRC resident who is a direct or indirect shareholder of an offshore company is required to update his registration with the relevant SAFE branches, with respect to that offshore company, in connection with any material change involving an increase or decrease of capital, transfer or swap of shares, merger, division, equity or debt investment or creation of any security interest. Moreover, the PRC subsidiaries of that offshore company are required to coordinate and supervise the filing of SAFE registrations by the offshore company's shareholders who are PRC residents in a timely manner. If a PRC shareholder with a direct or indirect stake in an offshore parent company fails to make the required SAFE registration, the PRC subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries, and the offshore parent company may also be prohibited from injecting additional capital into its PRC subsidiaries. Furthermore, failure to comply with the various SAFE registration requirements described above may result in liability for the PRC shareholders and the PRC subsidiaries under PRC law for foreign exchange registration evasion.

Although we have requested our PRC shareholders and beneficial owners to complete the SAFE Circular No. 75 registration, we cannot be certain that all of our PRC resident beneficial owners will comply with the SAFE regulations. The failure or inability of our PRC shareholders and beneficial owners to receive any required approvals or make any required registrations may subject us to fines and legal sanctions, restrict our overseas or cross-border investment activities, prevent us from transferring the net proceeds of this offering or making other capital injection into our PRC subsidiaries, limit our PRC subsidiaries' ability to make distributions or pay dividends or affect our ownership structure, as a result of which our acquisition strategy and business operations and our ability to distribute profits to you could be materially and adversely affected.

Under Operating Rules on the Foreign Exchange Administration of the Involvement of Domestic Individuals in the Employee Stock Ownership Plans and Share Option Schemes of Overseas Listed Companies, issued and effective as of March 28, 2007 by the State Administration of Foreign Exchange, or "SAFE" ("Circular No. 78"), PRC residents who are granted shares or share options by an overseas listed company according to its employee share option or share incentive plan are required to obtain approval from and register with the SAFE or its local branches and complete certain other procedures related to the share option or other share incentive plan through the PRC subsidiary of such overseas listed company or any other qualified PRC agent before such grants are made. We believe that all of our PRC employees who are granted share options are subject to SAFE No. 78. As of September 30, 2010, we had granted options to purchase up to 15,000 shares of common stock to two PRC residents. We have requested our PRC management, personnel, directors, employees and consultants who have been granted or are to be granted stock options to register them with local SAFE pursuant to Circular No. 78. However, we cannot assure you that each of these individuals has carried out or will carry out all the required procedures above. If we or our PRC option holders fail to comply with these regulations, we or our PRC option holders may be subject to fines and legal sanctions. Further, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for foreign exchange evasion and we may become subject to a more stringent review and approval process with respect to our foreign exchange activities.

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We must comply with the Foreign Corrupt Practices Act.

We are required to comply with the United States Foreign Corrupt Practices Act, which prohibits U.S. companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Foreign companies, including some of our competitors, are not subject to these prohibitions. Certain of our customers are PRC government entities and our dealings with them are likely to be considered to be with government officials for these purposes. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time-to-time in the PRC. If our competitors engage in these practices, they may receive preferential treatment from personnel of some companies, giving our competitors an advantage in securing business or from government officials who might give them priority in obtaining new licenses, which would put us at a disadvantage. We could suffer severe penalties if our employees or other agents were found to have engaged in such practices.

Under the PRC EIT Law, we and/or Wiscon may be classified as a "resident enterprise" of the PRC. Such classification could result in tax consequences to us, our non-PRC resident investors and/or Wiscon.

On March 16, 2007, the National People's Congress approved and promulgated a new tax law, the PRC Enterprise Income Tax Law (the "EIT Law") which took effect on January 1, 2008. Under the EIT Law, enterprises are classified as resident enterprises and non-resident enterprises. An enterprise established outside of China with "de facto management bodies" within China is considered a "resident enterprise," meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the EIT Law define "de facto management bodies" as a managing body that in practice exercises "substantial and overall management and control over the production and operations, personnel, accounting, and properties" of the enterprise; however, it remains unclear whether the PRC tax authorities would deem our de facto managing body as being located within China. Due to the short history of the EIT Law and lack of applicable legal precedents, the PRC tax authorities determine the PRC tax resident treatment of a foreign (non-PRC) company on a case-by-case basis.

If the PRC tax authorities determine that we and/or Wiscon are a "resident enterprise" for PRC enterprise income tax purposes, a number of PRC tax consequences could follow. First, we and/or Wiscon may be subject to the enterprise income tax at a rate of 25% on our and/or Wiscon's worldwide taxable income, in addition to our PRC enterprise income tax reporting obligations. Second, under the EIT Law and its implementing rules, dividends paid between "qualified resident enterprises" are exempt from enterprise income tax. As a result, if we and Wiscon are treated as PRC "qualified resident enterprises," all dividends from Suoke Clean Energy to us (through Wiscon) should be exempt from PRC tax.

If Wiscon were treated as a PRC "non-resident enterprise" under the EIT Law, then dividends that Wiscon receives from Suoke Clean Energy (assuming such dividends were considered sourced within the PRC) (i) may be subject to a 5% PRC withholding tax, provided that Wiscon owns more than 25% of the registered capital of Suoke Clean Energy continuously within 12 months immediately prior to obtaining such dividend from Suoke Clean Energy, and the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the "PRC-Hong Kong Tax Treaty") were otherwise applicable, or (ii) if such treaty does not apply (i.e. because the PRC tax authorities may deem Wiscon to be a conduit not entitled to treaty benefits), may be subject to a 10% PRC withholding tax. Similarly, if we were treated as a PRC "non-resident enterprise" under the EIT Law and Wiscon were treated as a PRC "resident enterprise" under the EIT Law,

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then dividends that we receive from Wiscon (assuming such dividends were considered sourced within the PRC) may be subject to a 10% PRC withholding tax. Any such taxes on dividends could materially reduce the amount of dividends, if any, we could pay to our shareholders.

Finally, if we are determined to be a "resident enterprise" under the EIT law, this could result in a situation in which (i) a 10% PRC enterprise income tax is imposed on dividends we pay to our investors that are not tax residents of the PRC ("non-resident investors") and that are enterprises (but not individuals) and gains derived by them from transferring our common stock, or (ii) up to a 20% PRC individual income tax is imposed on dividends that we pay to our non-resident investors who are individuals and gains derived by them from transferring our common stock, in each case if such income or gain is considered PRC-sourced income by the relevant PRC authorities. In such event, we may be required to withhold the applicable PRC tax on any dividends paid to our non-resident investors. Our non-resident investors also may be responsible for paying the applicable PRC tax on any gains realized from the sale or transfer of our common stock in certain circumstances. We would not, however, have an obligation to withhold PRC tax with respect to such gain under the PRC tax laws.

The SAT released Circular Guoshuihan No. 698 ("Circular 698") on December 10, 2009, which reinforces the taxation of certain equity transfers by non-resident investors through overseas holding vehicles. Circular 698 addresses indirect equity transfers as well as other issues. Circular 698 is retroactively effective from January 1, 2008. According to Circular 698, where a non-resident investor who indirectly holds an equity interest in a PRC resident enterprise through a non-PRC offshore holding company indirectly transfers an equity interest in a PRC resident enterprise by selling the equity interest in the offshore holding company, and the latter is located in a country or jurisdiction where the actual tax burden is less than 12.5 percent or where the offshore income of its residents is not taxable, the non-resident investor is required to provide the PRC tax authority in charge of that PRC resident enterprise with certain relevant information within 30 days from the date of execution of the transfer agreements. The responsible tax authorities will evaluate the offshore transaction for tax purposes. In the event that the PRC tax authorities determine that such transfer is an abuse of forms of business organization and a reasonable commercial purpose for the offshore holding company other than the avoidance of PRC income tax liability is lacking, the PRC tax authorities will have the power to re-assess the nature of the equity transfer under the doctrine of substance over form. If the SAT's challenge of a transfer is successful, it may deny the existence of the offshore holding company that is used for tax planning purposes and subject the non-resident investor to PRC tax on the capital gain from such transfer. Since Circular 698 has a short history, there is uncertainty as to its application. We (or a non-resident investor) may become at risk of being taxed under Circular 698 and may be required to expend valuable resources to comply with Circular 698 or to establish that we (or such non-resident investor) should not be taxed under Circular 698, which could have a material adverse effect on our financial condition and results of operations (or such non-resident investor's investment in us).

If any such PRC income tax applies to a non-resident investor, the non-resident investor may be entitled to a reduced rate of PRC tax under an applicable income tax treaty and/or a deduction for such PRC tax against such investor's domestic taxable income or a foreign tax credit in respect of such PRC tax against such investor's domestic income tax liability (subject to applicable conditions and limitations). Prospective investors should consult with their own tax advisors regarding the applicability of any such taxes, the effects of any applicable income tax treaties, and any available deductions or foreign tax credits.

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For a further discussion of these issues, see the section of this prospectus captioned "PRC Income Tax Considerations."

The payment of dividends in the PRC is subject to limitations. We may not be able to pay dividends to our stockholders.

We conduct all of our business through our subsidiaries incorporated in the PRC. We rely on dividends paid by these consolidated subsidiaries for our cash needs, including the funds necessary to pay any dividends and other cash distributions to our stockholders, to service any debt we may incur and to pay our operating expenses. The payment of dividends by entities established in the PRC is subject to limitations. Regulations in the PRC currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in the PRC, subject to certain statutory procedural requirements. Each of our PRC subsidiaries, including wholly foreign owned enterprises, is also required to set aside at least 10% of their after-tax profit based on PRC accounting standards each year to their general reserves or statutory reserve fund until the aggregate amount of such reserves reaches 50% of their respective registered capital. Our statutory reserves are not distributable as loans, advances or cash dividends. In addition, if any of our PRC subsidiaries incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us. Any limitations on the ability of our PRC subsidiaries to transfer funds to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us and our management.

All of the assets of Suoke Clean Energy, Suo'ang New Energy and Shenyang Energy are located in, and all of our executive officers and our directors reside within, China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon our senior executive officers and directors who do not reside in the United States, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our Chinese counsel has advised us that China does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts. As a result, our public stockholders may have substantial difficulty in protecting their interests through actions against our management or directors that stockholders of a corporation with assets and management members located in the United States would not experience.

Governmental control of currency conversion may affect the value of your investment.

The PRC government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of China. We receive all of our revenue in RMB. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiaries and our affiliated entities to remit sufficient foreign currency to pay dividends or other payments to us. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, dividend payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from SAFE by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies.

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Fluctuation in the value of RMB may have a material adverse effect on your investment.

Since 1994, the conversion of RMB into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the People's Bank of China ("PBOC"), which are set daily based on the previous day's PRC interbank foreign exchange market rate and current exchange rates on the world financial markets. Since 1994, the official exchange rate for the conversion of RMB to U.S. dollars has generally been stable. On July 21, 2005, however, PBOC announced a reform of its exchange rate system. Under the reform, RMB is no longer effectively linked to U.S. dollars but instead is allowed to trade in a tight 0.3% band against a basket of foreign currencies.

The value of RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. Our revenues and costs are mostly denominated in RMB. Any significant fluctuation in value of RMB may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our stock in U.S. dollars. For example, an appreciation of RMB against the U.S. dollar would make any new RMB denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into RMB for such purposes.

We have not made statutory contributions to the public housing fund for our employees in accordance with applicable regulations, and this could subject us to fines and other penalties.

Although the PRC State Council has regulations governing a company's contribution to the public housing fund for its employees, we had not been expressly required by our local government authority in charge of this matter to make such contribution due to lack of implementing rules. In 2009, the Tongchuan Public Housing Fund Management Center, the local government department in charge of public housing fund matters, issued a notification which requires companies like us to make contributions to the local public housing fund for our employees. We are in the process of establishing a public housing fund account with the Tongchuan Public Housing Fund Management Center, and will begin to make statutory contributions for our employees to such account once it is open. However, we cannot assure you that the Tongchuan Public Housing Fund Management Center will not penalize us for non-compliance with the regulation promulgated by the State Council prior to 2010. If the relevant local public housing fund administrative centre takes any legal action against us for our non-compliance with such regulation, such as fines, or the requirement of making up contributions to the public housing fund for our employees, our financial conditions and results of operations may be adversely affected.

We currently operate our business in buildings we have constructed on land where we own or lease the land use right. Failure to have the legitimate and sustainable right to own or lease the buildings or the land use right could have a material adverse effect on our operations.

We own the land use right to a total of 43,956 square meters of land for our existing site in Tongchuan for a period of 50 years, expiring on December 8, 2057. However, we have not yet paid the required land grant fees and other taxes and fees. If we fail to pay the land grant fees and other requisite taxes and fees, the applicable land administration authority may rescind our land grant contract, ask for compensation for the violation of the contract, or revoke our Land Use Right Certificate. Any penalty or revocation of the Land Use Right Certificate could have a material adverse effect on our business, results of operation and financial condition.

For the operation of Suo'ang New Energy, on the land for which we lease the Land Use Right Certificate, we constructed a building according to our construction land use planning permit; however, we did not obtain other required construction project permits and other documents,

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including construction project planning permits, construction commencement permits and fire prevention design and inspection related documents. Upon completion of construction, we did not apply for the required inspection and acceptance examination of the building, and consequently, we did not obtain the Property Ownership Certificate. If we fail to obtain the required construction related permits and other documents, complete the inspection and acceptance examination of the building and obtain the Property Ownership Certificate, the applicable construction authority may impose a fine of up to 10% of the construction costs, or in limited circumstances, order the demolition of the building. Any penalty or request to demolish the building could have a material adverse effect on our business, results of operation and financial condition.

For the operation of the Shenyang Energy operation, we constructed our buildings on land on which we leased the land use right from a third party. We cannot be certain that the lessor has full power and authorization to lease the land use right to us. If our lessor has no legitimate power and authorization to lease the land use right to us, our lease of the land use right may be void. As a result, our business, results of operations and financial condition could be materially and adversely affected. In addition, as a lessee of the land use right, we are not entitled to apply for the construction related permits and documents, and consequently, we do not own the title of the buildings constructed on the leased land. On June 11, 2010, we entered into a Transfer Agreement with the lessor in connection with the CWSF Construction Project at the Shenyang site. Pursuant to the agreement, we have the contractual right to request the lessor to transfer ownership of buildings constructed by us on the site after the lessor obtains the Property Ownership Certificate from the Shenyang Property Administration Authority and Construction Administration Authority and we comply with all legal and regulatory requirements in obtaining the ownership of the buildings from the lessor. Although we have made requests to the lessor to obtain the required permits and certificate, as of the date of this prospectus, our lessor has not obtained the required construction related permits, nor the Property Ownership Certificate for the buildings. If our lessor fails to obtain these permits, certificates and other documents, the applicable construction authority may impose a fine of up to 10% of the construction costs, or in limited circumstances, order the demolition of the building. Any penalty or request to demolish the building could have a material adverse effect on our business, results of operation and financial condition.

In August 2010, through our subsidiary, Suoke Clean Energy, we entered into an agreement to purchase a land use right for approximately 5 acres of land and a production factory in Dongguan, Guandong Province. In addition, in September 2010, we entered into an agreement to purchase two production lines to be operated within the new Guangdong facility. The factory is currently undergoing refurbishment and the production lines are being completed and serviced. We anticipate that all of the work will be done by December 2010. We are in the process of taking the necessary steps to obtain a land use right certificate, which is required for us to obtain the rights to use the land and the title to the buildings. Failure to obtain the land use right certificate could have a material adverse effect on our business, results of operation and financial condition.

Our principal executive and administrative offices are located in Xi'an City, Shaanxi Province, China, with approximately 233 square meters of office space. Through Suoke Clean Energy, we entered into a real property purchase agreement with Xi'an Shengrong Real Estate Co., Ltd., dated January 12, 2010 to purchase this office space, for a purchase price of RMB1,586,798 (approximately $230,000). Xi'an Shengrong Real Estate Co., Ltd. has been granted the land use right to the property on which the building is located until June 19, 2052. We have applied for a transfer of this office's title to Suoke Clean Energy, but the title transfer process has not yet been completed. As a result, Suoke Clean Energy is not a legal owner of this office until title to the office has been duly transferred to Suoke Clean Energy. As our registered address is not in Xi'an City, we are required to register as a branch office in Xi'an City. We have submitted to the local authorities an application for the establishment and registration as a branch office, however failure to have registered a branch office in Xi'an may subject us to a fine up to RMB 100,000 or we may even be ordered to close our offices in Xi'an. Any penalty or request to close offices could have an adverse effect on our business, results of operation and financial condition.

We currently have not paid sufficient social welfare insurance contributions on behalf of our employees. If we fail to settle unpaid social insurance, we may be subject to a penalty.

Under PRC law, our PRC subsidiaries are obligated to pay social welfare insurance contributions to a public fund on behalf of our employees, including pension, work-related injury insurance, unemployment insurance, medical insurance and maternity insurance, in accordance with the premium rates stipulated by the local PRC government. We are required, but have not yet, registered with and obtained the Social Security Registration Certificate for our PRC subsidiaries from the local labor and social security authority. Since the amount of social insurance due is based on actual payment of salary, our PRC subsidiaries may not adjust their payment of social insurance in a timely manner and may pay below the required premium rates. We intend to settle unpaid social insurance. If we fail to settle unpaid social insurance, an employee may terminate his or her labor contract without prior notice, we may be fined by the local government authorities, and we may be ordered by the local labor and social security authority to make up the unpaid social insurance within a prescribed time limit.

Risks Related to an Investment in Our Securities

The full exercise of our outstanding warrants could result in substantially depressing the prevailing market prices for our common stock.

The full exercise of outstanding warrants could result in the substantial dilution of our common stock in terms of a particular percentage ownership in the company as well as the book value of common stock. The sale of a large amount of common stock received upon the exercise of the warrants on the public market, or the perception that such sales could occur, could substantially depress the prevailing market prices for our common stock.

As of September 30, 2010, there were 3,633,535 warrants outstanding from the financings that closed in September 2008 and July 2009. In the event of the exercise of these warrants, a stockholder will suffer substantial dilution of his, her or its investment in terms of the percentage ownership in us as well as the book value of the shares of common stock held.

To date, we have not paid any cash dividends and no cash dividends are expected to be paid in the foreseeable future.

We do not anticipate paying cash dividends on our common stock in the foreseeable future and we may not have sufficient funds legally available to pay dividends. Even if the funds are legally available for distribution, we may nevertheless decide not to pay any dividends. We currently intend to retain all earnings for our operations.

Our common stock is thinly traded and you may be unable to sell at or near ask prices or at all if you need to sell your shares to raise money or otherwise desire to liquidate your shares.

Our common stock has historically been sporadically or "thinly-traded" on the Over-the-Counter Bulletin Board, meaning that the number of persons interested in purchasing our common stock at or near bid prices at any given time may be relatively small or non-existent. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and may be reluctant to follow a newer company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. On June 14, 2010, our common stock was listed on the NASDAQ Global Market. We cannot give you any assurance that a broader or more active public trading market for our common stock will develop on the NASDAQ Global Market or be sustained, or that current trading levels will be sustained.

The market price for our common stock is particularly volatile given our status as a relatively small company with a small and thinly traded "float" that could lead to wide fluctuations in our share price. The price at which you purchase our common stock may not be indicative of the price that will prevail in the trading market. You may be unable to sell your common stock at or above your purchase price if at all, which may result in substantial losses to you.

The market for our common stock is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than that of a more seasoned issuer for the indefinite future. The volatility in our share price is attributable to a number of factors. First, as noted above, our common stock is sporadically and/or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our stockholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large amount of our common stock are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without an adverse impact on its share price. Secondly, we are a speculative or "risky" investment due to our limited operating history and uncertainty of future market acceptance for our current and potential products. As a consequence of this enhanced risk, more risk-adverse investors may be more inclined to sell their shares on the market more quickly and at greater discounts than would be the case with the stock of a seasoned issuer.

Many of these factors are beyond our control and may decrease the market price of our common stock, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common stock will be at any time, including as to whether our common stock will sustain its current market price, or as to what effect the sale of shares or the availability of common stock for sale at any time will have on the prevailing market price.

Volatility in our common stock price may subject us to securities litigation.

The market for our common stock is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. In the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may, in the future, be the target of similar litigation, which could result in substantial costs and liabilities and could divert management's attention and resources.

Our corporate actions are substantially controlled by our principal stockholders and affiliated entities.

As of the date of this prospectus, our management, directors and their affiliated entities own approximately 4,042,875 of our outstanding common stock, representing approximately 24% of our voting power. These stockholders, acting individually or as a group, could exert substantial influence over matters such as electing directors and approving mergers or other business combination transactions. In addition, because of the percentage of ownership and voting concentration in these principal stockholders and their affiliated entities, elections of our board of directors will generally be within the control of these stockholders and their affiliated entities. While all of our stockholders are entitled to vote on matters submitted to our stockholders for approval, the concentration of shares and voting control presently lies with these principal stockholders and their affiliated entities. As such, it would be difficult for stockholders to propose and have approved proposals not supported by management. There can be no assurances that matters voted upon by our officers and directors in their capacity as stockholders will be viewed favorably by all stockholders of the company.

The elimination of liability of our directors, officers and employees under Nevada law and the existence of indemnification rights to our directors, officers and employees may result in substantial expenditures by our company and may discourage lawsuits against our directors, officers and employees.

Our articles of incorporation contains a provision that eliminates the liability of our directors to our company and stockholders to the extent allowed under Nevada law, and we are prepared to give such indemnification to our directors and officers to the extent provided by Nevada law. We also have contractual indemnification obligations under our agreements with some of our directors. The foregoing indemnification obligations could result in our company incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which we may be unable to recoup. These provisions and resultant costs may also discourage our company from bringing a lawsuit against directors and officers for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our stockholders against our directors and officers even though such actions, if successful, might otherwise benefit our company and stockholders.

Past company activities prior to the reverse merger may lead to future liability for the Company.

Prior to the closing of the reverse merger transaction on October 20, 2006, we were engaged in businesses unrelated to our current operations. Although certain prior Company stockholders have provided certain indemnifications against any loss, liability, claim, damage or expense arising out of or based on any breach of or inaccuracy in any of their representations and warranties made in connection with the Exchange Agreement, any liabilities relating to such prior business against which we are not completely indemnified may have a material adverse effect on the Company.

The market price for our stock may be volatile.

The market price for our stock may be volatile and subject to wide fluctuations in response to factors including the following:

- actual or anticipated fluctuations in our quarterly operating results;
- changes in financial estimates by securities research analysts;
- conditions in alternative energy and coal-based product markets;
- changes in the economic performance or market valuations of other alternative energy and coal-based products companies;

- announcements by us or our competitors of new products, acquisitions, strategic partnerships, joint ventures or capital commitments;
- additions or departures of key personnel;
- intellectual property litigation; and
- general economic or political conditions in China.

In addition, the securities market has from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our common stock.

We may need additional capital, and the sale of additional common stock or other equity securities could result in additional dilution to our stockholders.

We believe that our current cash and cash equivalents, net proceeds from this offering and anticipated cash flow from operations will be sufficient to meet our anticipated cash needs for the near future. We may, however, require additional cash resources due to our business expansion plans, changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our resources are insufficient to satisfy our cash requirements, we may seek to sell equity or debt securities or obtain a credit facility. The sale of equity securities could result in dilution to our stockholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

Shares eligible for future sale may adversely affect the market.

From time to time, certain of our stockholders may be eligible to sell all or some of their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144 promulgated under the Securities Act of 1933, as amended (the "Securities Act"), subject to certain limitations. In general, pursuant to amended Rule 144, non-affiliate stockholders may freely sell their shares after six months subject only to the current public information requirement (which disappears after one year). Affiliates may freely sell their shares after six months subject to the Rule 144 volume, manner of sale (for equity securities), current public information and notice requirements. Of 16,792,239 shares of our common stock outstanding as of the date of this prospectus, 3,820,849 shares are freely tradable without restriction. Any substantial sale of our common stock pursuant to Rule 144 or pursuant to any resale prospectus may have a material adverse effect on the market price of our common stock.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

We are subject to reporting obligations under the U.S. securities laws. The SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, as amended, adopted rules requiring every public company to include a management report on such company's internal controls over financial reporting in its annual report, which contains management's assessment of the effectiveness of our internal

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controls over financial reporting. In our annual report on Form 10-K for the year ended December 31, 2009, we reported certain material weaknesses involving control activities, specifically:

1. Although we have hired additional accounting and operations personnel, we are still in the progress of developing proper financial reporting procedures and policies for (i) accounting for complex and non-routine transactions, (ii) closing our financial statements at the end of a period, (iii) disclosure requirements and processes for SEC reporting.

2. As a small company, we do not have sufficient personnel to set up adequate review functions at each reporting level.

3. As of December 31, 2009, we have not kept a complete set of ledgers of the parent, shell company. The parent company has no physical operation and has been mainly functioning as a pass-through legal entity for financing subsidiary companies that are operating overseas.

Our management has undertaken steps to address these issues, including the engagement of a new chief financial officer whom management believes has the requisite financial reporting experience, skills and knowledge to complement our existing personnel. Additionally, four independent directors now sit on our board of directors, including a member who is appropriately credentialed as a financial expert. The independent directors have been tasked to establish certain internal audit functions within our company, and we have also established audit and compensation committees comprised entirely of independent directors. We have also hired additional accounting and operational personnel and in April 2010, we engaged the Shanghai office of Ernst & Young as an outside consultant to assist with evaluating and improving our accounting system and working process (including internal audit and material transaction review and verification process) to strengthen the timeliness and efficiency of our disclosure and internal controls and procedures. However, there is no assurance that additional remedial measures will not be necessary, or that after the remediation our management will be able to conclude that our internal controls over our financial reporting are effective.

Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future. Effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, our failure to achieve and maintain effective internal controls over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading price of our common stock. Furthermore, we anticipate that we will incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

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FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements (as defined in Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act")). To the extent that any statements made in this prospectus contain information that is not historical, these statements are essentially forward-looking. Forward-looking statements may be identified by the use of words such as "expects," "plans," "may," "anticipates," "believes," "should," "intends," "estimates" and other words or phrases of similar meaning. Although we believe that the expectations reflected in these forward-looking statements are reasonable and achievable, these statements are subject to a number of risks and uncertainties discussed under the headings "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this prospectus. All forward-looking statements attributable to us are expressly qualified by these and other factors. We cannot assure you that actual results will be consistent with these forward-looking statements.

Information regarding market and industry statistics contained in this prospectus is included based on information available to us that we believe is accurate. Forecasts and other forward-looking information obtained from this available information is subject to the same qualifications and the additional uncertainties accompanying any estimates of future market size, revenue and market acceptance of products and services. The forward-looking statements made in this prospectus relate only to events as of the date on which the statements are made. We do not undertake any obligation to publicly update any forward-looking statements. As a result, you should not place undue reliance on these forward-looking statements.

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USE OF PROCEEDS

We estimate that the net proceeds to us from this offering will be approximately $25,575,000 based on the offering price of $5.25 per share and after deducting the underwriting discounts and estimated offering expenses payable by us. The underwriters have an option to purchase an additional 819,750 shares from us. Assuming the over-allotment option is exercised in full by the underwriters and satisfied in full by us, we will receive an additional estimated $4,000,000 in net proceeds, after deducting underwriting discounts.

We intend to use the net proceeds from this offering to expand our CWSF production capacity at new and existing facilities throughout China and to pay approximately $8,755,000, which represents the remainder of the purchase price under an agreement to purchase land use rights and a production factory in Dongguan, Guangdong Province. We intend to use any remaining net proceeds for working capital and general corporate purposes. Additionally, to the extent permitted by applicable laws, we may choose to expand our current business through acquisitions of other complementary businesses. We currently have no agreements, understandings or commitments with respect to any acquisitions. Management will have significant discretion in applying the net proceeds from this offering. Pending specific application of the net proceeds, to the extent permitted by applicable laws, we plan to invest our net proceeds in short-term bank deposits.

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DIVIDEND POLICY

We have not paid, and do not currently intend to pay cash dividends on our common stock in the foreseeable future. Our policy is to retain all earnings, if any, to provide funds for operation and expansion of our business. We are a holding company incorporated in the State of Nevada and do not have any assets or conduct any business operations other than our investments in our subsidiaries. As a result of our holding company structure, we rely entirely on dividend payments from our PRC subsidiaries. PRC accounting standards and regulations currently permit payment of dividends only out of accumulated profits, a portion of which is required to be set aside for certain reserve funds. Our inability to receive all of the revenues from our PRC subsidiaries' operations may provide an additional obstacle to our ability to pay dividends if we so decide in the future. The declaration of dividends, if any, will be subject to the discretion of our board of directors, which may consider such factors as our results of operations, financial condition, capital needs and acquisition strategy, among others.

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MARKET FOR OUR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Our common stock has been listed on the NASDAQ Global Market under the symbol "SCEI" since June 14, 2010. From January 1, 2008 until May 7, 2010, our common stock was quoted on the Over-the-Counter Bulletin Board ("OTCBB") under the symbol "SCLX." After we effectuated a 1-for-10 reverse split on May 7, 2010, our symbol changed to "SCLXD" for a period of 20 business days until June 7, 2010, and then resumed trading under the symbol "SCLX." The following table sets forth the high and low closing prices for our common stock for the periods indicated as reported by the NASDAQ Global Market and the OTCBB, as adjusted for the reverse stock split:

Quarter Ended	High	Low
2010:		
First Quarter	$ 8.50	$ 3.70
Second Quarter	9.40	6.11
Third Quarter	6.35	5.08
Fourth Quarter (through December 21, 2010)	8.85	5.67
2009:		
First Quarter	2.40	1.40
Second Quarter	4.50	1.60
Third Quarter	5.60	3.10
Fourth Quarter	6.80	4.10
2008:		
First Quarter	3.30	1.10
Second Quarter	2.50	1.10
Third Quarter	3.50	2.00
Fourth Quarter	2.70	1.40

Based upon information furnished by our transfer agent, as of September 30, 2010, we had 2,977 holders of record of our common stock. This number does not include beneficial owners of our common stock whose shares are held in the names of various dealers, clearing agencies, banks, brokers and other fiduciaries.

Equity Compensation Plan Information

As of December 31, 2009, we did not have any equity compensation plans in effect, although our board of directors may approve from time to time the issuance of equity compensation to our employees as additional compensation outside of an equity compensation plan.

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CAPITALIZATION

The following table summarizes our cash and cash equivalents and our consolidated capitalization as of September 30, 2010, on an actual basis and as of September 30, 2010 on an as adjusted basis to reflect our receipt of the estimated net proceeds from this offering.

You should read this table in conjunction with the sections of this prospectus entitled "Use of Proceeds," "Selected Consolidated Financial Information," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this prospectus.

	September 30, 2010 (unaudited)	
	Actual	**As Adjusted**[(1)]
Cash and cash equivalents	$ 34,348,096	$ 59,923,096
Shareholders' equity:		
Common stock, $0.001 par value, 30,000,000 shares authorized, 16,792,239 issued shares outstanding at September 30, 2010, and 21,292,239 on an as adjusted basis	$ 16,792	22,257
Preferred stock, $0.001 par value, 50,000,000 shares authorized, none issued and outstanding at September 30, 2010		
Additional paid-in capital	37,805,971	63,375,506
Statutory reserves	1,758,553	1,758,553
Accumulated other comprehensive income	2,488,534	2,488,534
Accumulated deficit	(790,260)	(790,260)
Total shareholders' equity	41,279,590	66,854,590
Total capitalization	41,279,590	66,854,590

(1) Reflects the results of the sale by us of 5,465,000 shares of common stock in this offering at the public offering price of $5.25 per share and our receipt of approximately $25,575,000 of the estimated net proceeds of the offering, after deducting underwriting discounts and estimated offering expenses payable by us.

The table above excludes as of September 30, 2010.

3,633,535 shares of our common stock issuable upon the exercise of warrants with a weighted average exercise price of $2.56 per share; and

65,000 shares of our common stock issuable upon exercise of options outstanding with a weighted average exercise price of $7.25 per share.

819,750 shares of our common stock issuable upon exercise of the underwriters' over-allotment option, if any.

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EXCHANGE RATE INFORMATION

Our financial statements and other financial data included in this prospectus are presented in U.S. dollars. Our business and operations are primarily conducted in China through our PRC subsidiaries. The functional currency of our PRC subsidiaries is RMB and their revenues and expenses are denominated in that currency. The conversion of RMB into U.S. dollars in this prospectus is based on the noon buying rate in the City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. For convenience, certain amounts in RMB have been converted to United States dollars. Assets and liabilities are converted at the exchange rate as of the balance sheet date. Income and expenses are converted at the average exchange rate for the period. We make no representation that any RMB or U.S. dollar amounts referred to in this prospectus could have been or could be converted into U.S. dollars or RMB, as the case may be, at any particular rate or at all.

The following table sets forth, for each of the periods indicated, the average, high, low and period-end noon buying rates in New York City for cable transfers, in RMB per U.S. dollar, as certified for customs purposes by the Federal Reserve Bank of New York. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this prospectus or will use in the preparation of our periodic reports or any other information to be provided to you.

Renminbi per U.S. Dollar Noon Buying Rate

	Average[(1)]	High	Low	Period-End
Year ended December 31, 2008	6.8532	6.9870	6.7899	6.8329
Year ended December 31, 2009	6.8286	6.8470	6.8176	6.8259
2010				
January	6.8269	6.8295	6.8258	6.8268
February	6.8292	6.8346	6.8260	6.8260
March	6.8263	6.8270	6.8255	6.8258
April	6.8256	6.8275	6.8229	6.8247
May	6.8275	6.8310	6.8245	6.8305
June	6.8184	6.8323	6.7815	6.7815
July	6.7762	6.7807	6.7709	6.7735
August	6.7873	6.8069	6.7670	6.8069
September	6.7396	6.8102	6.6869	6.6905
October	6.6675	6.6912	6.6397	6.6705
November (through November 26)	6.6526	6.6906	6.6233	6.6675

(1) Annual averages are calculated from month-end rates. Monthly and interim period averages are calculated using the average of the daily rates during the relevant period.

Source: Federal Reserve Bank of New York

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SELECTED CONSOLIDATED FINANCIAL INFORMATION

The selected consolidated financial information for the years ended December 31, 2009 and December 31, 2008, and as of December 31, 2009 and December 31, 2008, is derived from our historical consolidated financial statements, which were audited by Weinberg & Company, P.A., an independent registered public accounting firm. The selected consolidated financial information for the nine months ended September 30, 2010 and September 30, 2009, and as of September 30, 2010, is derived from our unaudited consolidated financial statements included elsewhere in this prospectus. The unaudited consolidated financial statements have been prepared on a basis consistent with our audited consolidated financial statements. In the opinion of management, the unaudited consolidated financial information reflects all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the results for those periods. Results for interim periods are not necessarily indicative of results that may be expected for a full year. Historical results are not necessarily indicative of the results expected in the future. The selected consolidated financial information should be read in conjunction with, and is qualified by reference to, "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated audited and unaudited financial statements and the related notes appearing elsewhere in this prospectus.

	Nine Months Ended September 30,		Year Ended December 31,	
	2010 (unaudited)	2009 (unaudited)	2009	2008
Income Statement Data:				
Revenue	$ 73,571,899	$ 26,982,573	$ 46,012,353	$ 14,253,989
Cost of goods sold	(44,448,913)	(17,695,505)	(28,922,846)	(9,266,832)
Gross profit	29,122,986	9,287,068	17,089,507	4,987,157
Selling expenses	3,203,245	422,405	1,125,884	13,128
General and administrative expenses	1,925,072	1,452,975	1,796,032	554,766
Income from operations	23,994,669	7,411,688	14,167,591	4,419,263
Other income (expense), net	15,658,614	(35,163,733)	(46,749,191)	(962,560)
Income (loss) before income taxes and non-controlling interest	39,653,283	(27,752,045)	(32,581,600)	3,456,703
Provision for income taxes	4,640,556	1,055,718	2,243,088	105,249
Net income (loss)	35,012,727	(28,807,763)	(34,824,688)	3,351,454
Net income allocable to non-controlling interest				(351,849)
Net income (loss) allocable to Sino Clean Energy Inc.	$ 35,012,727	$ (28,807,763)	$ (34,824,688)	$ 2,999,605
Basic earnings (loss) per share	$ 2.28	$ (3.00)	$ (3.56)	$ 0.34
Diluted earnings (loss) per share	$ 1.88	$ (3.00)	$ (3.56)	$ 0.34
Basic weighted average shares outstanding	15,385,062	9,609,130	9,792,922	8,716,962
Diluted weighted average shares outstanding	18,668,856	9,609,130	9,792,922	8,816,208

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Reconciliation of Net Income (Loss) to unaudited Non-GAAP Adjusted Earnings

The following table includes a reconciliation of our Net Income (Loss) to unaudited Non-GAAP Adjusted Earnings for the nine months ended September 30, 2010 and 2009 and for the years ended December 31, 2009 and 2008:

	For Nine Months Ended September 30,		For Years Ended December 31,	
	2010 (unaudited)	2009 (unaudited)	2009	2008
Net income (loss)	$ 35,012,727	$ (28,807,763)	$ (34,824,688)	$ 2,999,605
Amortization of discount on convertible notes	8,601,975	3,873,979	3,942,185	
Value of shares issued for bonus interest	1,864,701			
Expenses related to escrow shares		1,294,881	11,125,071	676,466
Gain on extinguishment of derivative liabilities	(28,404,181)	(3,370,593)	(7,046,556)	
Change in fair value of derivative liabilities	2,348,479	8,236,238	12,770,113	
Cost of private placement		24,794,842	24,977,114	
Non-GAAP Adjusted earnings (unaudited)	$ 19,423,701	$ 6,021,584	$ 10,943,239	$ 3,676,071
Non-GAAP Adjusted earnings per share Basic (unaudited)	$ 1.02	$ 0.30	$ 0.57	$ 0.36
Non-GAAP Adjusted earnings per share Diluted (unaudited)	$ 1.02	$ 0.30	$ 0.57	$ 0.36
Reconciliation of GAAP basic shares outstanding to Non-GAAP basic shares outstanding				
GAAP Basic Shares outstanding	15,385,062	9,609,130	9,792,922	8,716,962
Assumed conversion of convertible debentures		6,101,053	5,377,368	890,433
Assumed exercise of warrants	3,633,534	4,116,614	4,116,614	639,013
Non-GAAP Basic Shares outstanding	19,018,596	19,826,797	19,286,904	10,246,408
Reconciliation of GAAP diluted shares outstanding to Non-GAAP diluted shares outstanding				
GAAP Diluted shares outstanding	18,668,856	9,609,130	9,792,922	8,816,208
Assumed conversion of convertible debentures		6,101,053	5,377,368	890,433
Assumed exercise of warrants	349,740	4,116,614	4,116,614	539,767
Non-GAAP Diluted shares outstanding	19,018,596	19,826,797	19,286,904	10,246,408

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	September 30, 2010		As of December 31,	
	Actual (unaudited)	As Adjusted(1) (unaudited)	2009	2008
Balance Sheet Data:				
Cash and cash equivalents	$ 34,348,096	$ 59,923,096	$ 18,302,558	$ 3,914,306
Working capital	20,173,642	45,748,642	7,730,396	5,716,968
Total assets	66,239,056	91,114,056	44,633,779	21,105,793
Derivative liabilities	19,101,337	19,101,337	45,157,039	
Total liabilities	24,959,466	24,259,466	51,094,990	2,159,441
Stockholders' equity	41,279,590	66,854,590	(6,461,211)	18,946,352
Total liabilities and stockholders' equity	66,239,056	91,114,056	44,633,779	21,105,793

(1) Reflects the results of the sale by us of 5,465,000 shares of common stock in this offering at the public offering price of $5.25 per share and our receipt of approximately $25,575,000 of the estimated net proceeds of the offering, after deducting underwriting discounts and estimated offering expenses payable by us.

Non-GAAP Financial Measure

Non-GAAP Adjusted earnings and non-GAAP adjusted earnings per share are not measures of financial performance under U.S. GAAP, and should not be considered in isolation or as an alternative to net income (loss) and earnings per share. We define non-GAAP adjusted earnings as net income (loss) excluding charges for the change in derivatives, gains on the extinguishment of derivatives, cost of private placements, which represents the excess of the fair value of the derivative liability created upon issuance of the notes over the amounts received, shares issued for bonus interest, expenses related to escrow shares, and other non-cash financing costs. We believe non-GAAP adjusted earnings is an important measure of operating performance because it allows management, securities analysts, investors and others to evaluate and compare our core operating results to other companies in our industry, including our return on capital and operating efficiencies, from period to period by removing the impact of our costs of private placements, derivative liabilities and other non-cash financing costs. Non-GAAP basic and diluted shares reflects the potential dilution that could occur if convertible debentures and warrants that represent derivatives and note discount were exercised or converted into common stock. Other companies may calculate non-GAAP adjusted earnings differently, and therefore our non-GAAP adjusted earnings and non-GAAP adjusted earnings per share may not be comparable to similarly titled measures of other companies.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our results of operations and financial condition is based upon, and should be read in conjunction with, our consolidated financial statements and accompanying notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements. Actual results could differ materially from the results discussed in the forward-looking statements. Please see "Risk Factors" and "Forward-Looking Statements" for a discussion of some of the uncertainties, risks and assumptions associated with these statements.

Our financial statements are prepared in U.S. Dollars and in accordance with accounting principles generally accepted in the United States. See "Exchange Rates" above for information concerning the exchange rates at which Renminbi were translated into U.S. Dollars at various pertinent dates and for pertinent periods.

Overview

Sino Clean Energy Inc. is a holding company that, through its wholly-owned PRC operating subsidiaries, based upon total third party sales revenue in China, is a leading producer and distributor of coal-water slurry fuel ("CWSF") in China. CWSF is a clean fuel that consists of fine coal particles suspended in water and mixed with chemical additives. Our CWSF products are mainly used to fuel boilers and furnaces to generate steam and heat for residential and industrial use. We sell our products in China and our customers include industrial, commercial, residential and government organizations. Our strong reputation in the CWSF industry in China, together with our established track record for consistently delivering high quality products in large quantities, has enabled us to expand our customer base since establishing commercial operations in 2007 to become the largest third-party CWSF producer in China, as measured by CWSF sales volumes for the first half of 2010. Third party CWSF producers do not include entities that produce CWSF in-house for their own consumption or, parties that import CWSF for sale.

Corporate Organization and History

Our current corporate structure is the result of a number of complex corporate restructurings through which we acquired control of our CWSF business in the PRC. We entered into this series of corporate restructurings in part because certain rules and regulations in the PRC restrict the ability of non-PRC companies that are controlled by PRC residents to acquire PRC companies.

We were originally incorporated in Texas as "Discount Mortgage Services, Inc." on July 11, 2000. In September 2001, we purchased Endo Networks, Inc., a Canadian software developer, and on November 5, 2001, changed our name to "Endo Networks, Inc." We re-domiciled to the State of Nevada on December 13, 2001.

On October 20, 2006 we consummated a share exchange transaction with Hangson, a British Virgin Islands company, the stockholders of Hangson and stockholders who held a majority of the shares of our common stock. We issued a total of 2,600,000 shares of our common stock to the Hangson stockholders and a consultant in the transaction, in exchange for 100% of the common stock of Hangson. As a result of the transaction we became engaged in the CWSF business in China, through the operations of Suo'ang BST and Suo'ang New Energy. On January 4, 2007, we changed our name from "Endo Networks, Inc." to "China West Coal Energy Inc.," and then on August 15, 2007, we changed to our present name, "Sino Clean Energy Inc." to better reflect the direction and business of the Company.

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Hangson was a holding company that controlled Suo'ang BST and Suo'ang BST's 80%-owned subsidiary Suo'ang New Energy, through a series of contractual arrangements. The remaining 20% of Suo'ang New Energy was owned by Mr. Peng Zhou, a member of our board of directors and, at that time, the chief operating officer of Suo'ang BST. Suo'ang BST, through Suo'ang New Energy, commenced CWSF production in July 2007. Although Hangson was entitled to acquire the remaining 20% of Suo'ang New Energy from Mr. Zhou, Mr. Zhou remained as the record shareholder of Suo'ang New Energy.

In 2009, we effected a reorganization of our corporate structure in order to make Suo'ang New Energy a wholly-owned subsidiary (the "2009 Reorganization"), which included entering into a series of agreements transferring the contractual arrangements, through which Hangson controlled Suo'ang BST, to Suoke Clean Energy.

On September 15, 2009, Suo'ang BST and Hangson entered into a share transfer agreement with Suoke Clean Energy pursuant to which Suo'ang BST and Hangson agreed to transfer 100% of the equity interests in Suo'ang New Energy to Suoke Clean Energy. However, since Mr. Zhou still owned 20% of Suo'ang New Energy, on November 10, 2009, Suo'ang BST and Hangson entered into a subsequent share transfer agreement with Suoke Clean Energy to transfer 80% of Suo'ang New Energy's equity interests to Suoke Clean Energy and, Mr. Zhou, with Hangson's consent, entered into a share transfer agreement with Suoke Clean Energy to transfer the remaining 20% equity interest of Suo'ang New Energy. On November 12, 2009, Suo'ang New Energy received a new business license from the Tongchuan Administration for Industry and Commerce, which reflected that the acquisition of 100% of the equity of Suo'ang New Energy by Suoke Clean Energy had been completed. As a result we were able, through Suoke Clean Energy to own 100% of the equity interests of Suo'ang New Energy. On October 12, 2009, Suo'ang New Energy established a wholly-owned subsidiary to conduct the CWSF business in Shenyang, Liaoning Province.

On December 31, 2009, we entered into a series of termination agreements to terminate the contractual arrangements by and among Suoke Clean Energy, Suo'ang BST and certain stockholders of Suo'ang BST. We no longer needed to keep such contractual arrangements in place due to the fact that Suo'ang BST was no longer engaged in any substantial business operations. In connection with the termination agreements, certain assets held by Suo'ang BST, such as office equipment, vehicles, bank deposits, and accounts receivable, were transferred to Suoke Clean Energy. Employees of Suo'ang BST signed new employment contracts with Suoke Clean Energy. All rights and obligations under certain business operation agreements and research and development contracts between Suo'ang BST and third parties were assigned to Suo'ang New Energy. Hangson has had no substantive operations of its own after the transfer and termination of the contractual arrangements.

On June 30, 2009, Hangson acquired all of the outstanding shares of Wiscon, a limited liability company incorporated in Hong Kong under the Companies Ordinance. On December 31, 2009, Hangson transferred all of the outstanding shares of Wiscon to Sino Clean Energy Inc. As a result, Wiscon became a direct wholly-owned subsidiary of Sino Clean Energy Inc.

Although the equity transfers in the PRC described above were approved by local governmental agencies, they were not approved by the PRC Ministry of Commerce ("MOFCOM") or the China Securities and Regulatory Commission (the "CSRC"). For a discussion of the risks and uncertainties arising from these PRC rules and regulations, see "Risk Factors The failure to comply with PRC regulations relating to mergers and acquisitions of domestic enterprises by offshore special purpose

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vehicles may subject us to severe fines or penalties, and create other regulatory uncertainties regarding our corporate structure."

Important Factors Affecting our Results of Operations

We believe that the most significant factors that affect our financial condition and results of operations are:

Economic conditions in China

We operate our manufacturing facilities in China and derive all of our revenue from sales to customers in China. As such, economic conditions in China will affect virtually all aspects of our operations, including the demand for our products, the availability and prices of our raw materials and our other expenses. China has experienced significant economic growth, achieving a compounded annual growth rate of 10% in gross domestic product from 1989 through 2008. We believe that economic conditions in China will continue to have a positive effect on our business and results of operations.

Supply and costs of coal as the principal raw material

Our ability to manage our costs depends significantly on our ability to secure affordable and steady supplies of coal, our primary raw material. We currently procure coal from three suppliers in Tongchuan, and two suppliers in Shenyang. We have historically been able to secure a sufficient supply of coal.

The cost of our primary raw material is subject to fluctuating market prices. For example, between December 31, 2008 and 2009, we experienced an increase in the average cost per metric ton of coal of 7.8%, from RMB 510 to RMB 550. Our operating costs may increase significantly if the price of our raw materials increases due to changes in consumption patterns or as a result of price fluctuations in the local coal market, which may be caused by numerous economic and regulatory factors. To the extent that we pass on the raw material cost increases to our customers, our revenue may also increase significantly as coal prices rise in the PRC market.

Market price for coal, oil and natural gas

We price our CWSF based on the market price of coal for two reasons: (1) past experiences indicate that we are able to sell CWSF at a slight discount to local retail coal prices; (2) because coal accounts for over 80% of our production costs, we are generally able to pass on a majority of the raw material cost increases to our customers.

Additionally, CWSF is a replacement fuel for oil and natural gas, and thus our business activities are affected by the price of, as well as the demand and supply of oil and natural gas. Changes in prices of oil or natural gas, any interruption in the supply of oil or natural gas, or any governmental regulation of the price of oil or natural gas may affect the adoption of CWSF as an alternative fuel in China. During recent years, oil and natural gas prices have fluctuated significantly.

The pricing of refined oil products is heavily regulated by the PRC government. The government periodically adjusts the price to reflect the international crude oil price movements. Any material change or delay in these guidance prices may affect the demand and the selling prices for our CWSF products.

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Demand for, and market awareness of, CWSF

We believe that Chinese companies are realizing the potential advantages of using CWSF as a replacement for coal briquettes, oil and natural gas. Our principal customers are industrial, commercial, government and residential users. These users select CWSF as a fossil fuel to create steam and heat in furnaces or boilers. Since January 2008, the average selling price of our CWSF exclusive of value added tax, increased by 16% from RMB 620 to RMB 720 per metric ton.

The CWSF industry is still in an early stage of development. We believe demand for our products will continue to grow as market awareness of CWSF as a substitute for coal briquettes, oil and natural gas increases. PRC law and government policies promote the development and utilization of clean energy, as well as the improved utilization of coal including CWSF.

Production capacity

In order to capture market share for our products, we have expanded, and plan to continue to expand, our production capacity. Increased capacity has had, and could continue to have, a significant effect on our results of operations, by allowing us to produce and sell more CWSF to generate higher revenues. Our annual production capacity increased from 100,000 metric tons in 2007 to 350,000 metric tons in February 2009, all based at our Tongchuan production facility, and to 650,000 metric tons as of October 2009 as we brought our Shenyang production facility online and finally to 850,000 metric tons by January 2010. We sold approximately 31,000 metric tons, approximately 137,000 metric tons and approximately 456,000 metric tons of CWSF in 2007, 2008, and 2009, respectively. During the first nine months of 2010, we sold approximately 685,000 metric tons of CWSF.

The demand for CWSF from residential heating customers tends to be seasonal in nature, with peak demand occurring between the months of October through March as these are the peak heating periods in the markets which the Company currently serves. Demand for CWSF during peak periods is approximately 30% to 40% higher than during low periods. Demand for CWSF from industrial customers tends to be fairly stable throughout the year, as their application of CWSF is often unrelated to heating. The volume demand of CWSF tends to follow seasonal variations. The price of CWSF tends to follow the price of coal as opposed to seasonal variations.

Gross Profit and Gross Margin

For the years ended December 31, 2009 and 2008, our gross margin was 37.1% and 35.0%, respectively. The primary reason for the fluctuations in our gross margin is related to changes in the price of washed coal, which is a key input in the production of CWSF. The increase in our gross margin in 2009 is also due to the commencement of CWSF production at the Company's Shenyang facility in October 2009, which sells CWSF at a higher margin than the Company's Tongchuan facility.

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Results of Operations

Comparison of Quarterly Periods Ended September 30, 2010 and 2009

The following tables set forth key components of our results of operations for the periods indicated.

	Three months ended September 30, (Unaudited)	
	2010	**2009**
Revenue	$ 24,913,134	$ 10,889,796
Cost of goods sold	(15,269,720)	(6,812,469)
Gross profit	9,643,414	4,077,327
Selling expenses	1,156,147	416,585
General and administrative expenses	579,837	471,644
Income from operations	7,907,430	3,189,078
Other income (expenses)		
Interest and finance costs	(1,047)	(3,149,499)
Expense related to escrow shares		(1,054,548)
Interest income	29,889	11,708
Change in fair value of derivative liabilities	(970,813)	(7,035,248)
Gain on extinguishment of derivative liability		2,381,333
Cost of private placement		(24,794,842)
Sundry expenses	(4,688)	
Total other income (expenses)	(946,659)	(33,641,096)
Income(loss) before provision for income taxes	6,960,771	(30,452,018)
Provision for income taxes	1,349,424	463,050
Net income	$ 5,611,347	$ (30,915,068)

Revenue. During the three-month period ended September 30, 2010, we had revenues from sales of our coal-water slurry fuel of $24,913,134 as compared to revenues of $10,889,796 during the three-month period ended September 30, 2009, an increase of 129%. This significant increase is primarily attributable to the increased production from the production line added in late 2009, which led to an increase in sales to existing customers. The annual production capacity as at September 30, 2010 was 850,000 tons after the commencement of our new CWSF production plant in Shenyang with annual output capacity of 300,000 tons and 200,000 production line added in Tongchuan, as compared to 350,000 tons as at September 30 2009. At September 30, 2010 we had 43 customers under CWSF supply agreements totaling approximately 900,000 tons per year, as compared to 23 customers totaling approximately 400,000 tons of CWSF per year as at September 30, 2009. We believe that our sales and number of customers in 2010 as compared to 2009 are indicative of the growing market acceptance of CWSF.

Cost of Goods Sold. Cost of goods sold, consisting of raw materials, direct labor and manufacturing overhead and depreciation of plant and machinery, was $15,269,720 for the three-month period ended September 30, 2010, as compared to $6,812,469 for the same period of 2009, an increase of 124%. The increase in cost of goods sold is in line with our increase in sales. However, gross profit margin improved from 37% in 2009 to 39% in 2010 mainly as a result of better pricing of CWSF in Shenyang.

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Selling Expenses. Selling expenses totaled $1,156,147 for the three-month period ended September 30, 2010, as compared to $416,585 for the three-month period ended September 30, 2009. This increase is mainly in transportation cost as a result of the growth of our business in 2010.

General and Administrative Expenses. General and administrative expenses totaled $579,837 for the three-month period ended September 30, 2010, as compared to $471,664 for the three-month period ended September 30, 2009, an increase of 24%. This increase was primarily caused by our professional expenses related to preparation of registration statements in 2010.

Income from Operations. Our income from operations for the three months ended September 30, 2010 was $7,907,430, an increase of 148% as compared to $3,189,078 for the same period in 2009, in line with the increase in sales in 2010.

Other Income (expense). Other expense totaled $(946,659) for the three-month period ended September 30, 2010, mainly as the result of the change in fair value of the derivative liabilities of $(970,813) as compared to other expense of $(33,641,096) for the three-month period ended September 30, 2009, primarily caused by the loss on change in fair value of derivative liabilities of $(7,035,248) and cost of private placement of $(24,794,842) which was partially set off by the gain on extinguishment of derivative liability of $2,381,333 in 2009.

Provision for income taxes. For the three-month period ended September 30, 2010 and 2009, our provision for income taxes was $1,349,424 and $463,050, respectively. The increase in income taxes reflects the increase in taxable income from our operations in China. For the three months ended September 30, 2010 and 2009, our effective tax rate was 19% and (1%), respectively, of income before provision for income taxes. In 2010 and 2009, our effective tax rate was increased by 5% and 37%, respectively, due to expenses related to financings and derivatives that are classified as permanent differences. Additionally, in 2010 and 2009, our effective tax rate was reduced by 9% and 1%, respectively, for certain tax holidays we enjoy in the PRC.

Net Income (loss). We had net income of $5,611,437 for the three-month period ended September 30, 2010, as compared to net loss of $30,915,068 for the same period in 2009. The increase in net income is primarily attributable to the increase in sales in 2010.

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Nine month period ended September 30, 2010 compared to nine month period ended September 30, 2009

The following tables set forth key components of our results of operations for the periods indicated.

	Nine months ended September 30, (Unaudited)	
	2010	**2009**
Revenue	$ 73,571,899	$ 26,982,573
Cost of goods sold	(44,448,913)	(17,695,505)
Gross profit	29,122,986	9,287,068
Selling expenses	3,203,245	422,405
General and administrative expenses	1,925,072	1,452,975
Income from operations	23,994,669	7,411,688
Other income (expenses)		
Interest and finance costs	(10,459,201)	(4,231,344)
Expense related to escrow shares		(1,294,881)
Interest income	62,113	22,979
Gain on extinguishment of derivative liability	28,404,181	3,370,593
Change in fair value of derivative liabilities	(2,348,479)	(8,236,238)
Cost of private placement		(24,794,842)
Total other income (expenses)	15,658,614	(35,163,733)
Income (loss) before provision for income taxes	39,653,283	(27,752,045)
Provision for income taxes	4,640,556	1,055,718
Net income (loss)	$ 35,012,727	$ (28,807,763)

Revenue. During the nine-month period ended September 30, 2010, we had revenues from sales of our coal water mixture of $73,571,899 as compared to revenues of $26,982,573 during the nine-month period ended September 30, 2009, an increase of 173%. This significant increase is primarily attributable to the increased production from the production line added in late 2009, which led to an increase in sales to existing customers. The annual production capacity as at September 30, 2010 was 850,000 tons after the commencement of our new CWSF production plant in Shenyang with annual output capacity of 300,000 tons and 200,000 production line added in Tongchuan , as compared to 350,000 tons as at September 30 2009 . At September 30, 2010 we had 43 customers under CWSF supply agreements totaling approximately 900,000 tons per year, as compared to 23 customers totaling approximately 400,000 tons of CWSF per year as at September 30, 2009. We believe that our sales and number of customers in 2010 as compared to 2009 are indicative of the growing market acceptance of CWSF.

Cost of Goods Sold. Cost of goods sold, consisting of raw materials, direct labor and manufacturing overhead and depreciation of plant and machinery, was $44,448,913 for the nine-month period ended September 30, 2010, as compared to $17,695,505 for the same period of 2009, an increase of 151%. The increase in cost of sales sold is in line with the increase in sales. However, gross profit margin improved from 34% in 2009 to 40% in 2010 mainly as a result of better pricing of CWSF in Shenyang.

Selling Expenses. Selling expenses totaled $3,203,245 for the nine-month period ended September 30, 2010, as compared to $422,405 for the nine-month period ended September 30, 2009.

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This increase in selling expenses is mainly due to increase in transportation cost as a result of the growth of our business in 2010.

General and Administrative Expenses. General and administrative expenses totaled $1,925,072 for the nine-month period ended September 30, 2010, as compared to $1,452,975 for the nine-month period ended September 30, 2009, an increase of 32%. This increase was primarily caused by our expansion in operations and the expenses related to being a public company.

Income from Operations. Our income from operations for the nine-month period ended September 30, 2010 was $23,994,669, an increase of 224% as compared to income from operations of $7,411,688 for the same period in 2009, in line with the increase in sales and expenses.

Other Income (Expense). Other income totaled $15,658,614 for the nine-month period ended September 30, 2010, as compared to other expense of $35,163,733 for the nine-month period ended September 30, 2009, primarily caused by the gain on extinguishment of derivative liability of $28,404,181 which was partially set off by the interest expense of $10,459,201 in 2010.

Provision for income taxes. For the nine-month period ended September 30, 2010 and 2009, our provision for income taxes was $4,640,556 and $1,055,718, respectively. The increase in income taxes reflects the increase in taxable income from our operations in China. For the nine-month period ended September 30, 2010 and 2009, our effective tax rate was 12% and (4)%, respectively, of income before provision for income taxes, due to expenses related to financings and derivatives that are classified as permanent differences. Additionally, in 2010 and 2009, our effective tax rate was reduced by 3%, for certain tax holidays we enjoy in the PRC.

Net Income (loss). We had net income of $35,012,727 for the nine-month period ended September 30, 2010, as compared to net loss of $28,807,763 for the same period in 2009. The increase in net income is primarily attributable to the increase in sales in the first nine months of 2010 and gain on extinguishment of derivative liability.

Comparison of Fiscal Years Ended December 31, 2009 and 2008

The following tables set forth key components of our results of operations for the periods indicated.

	For the Years Ended December 31,	
	2009	**2008**
	USD	**USD**
Revenue	$ 46,012,353	$ 14,253,989
Cost of goods sold	(28,922,846)	(9,266,832)
Gross profit	17,089,507	4,987,157
Selling expenses	(1,125,884)	(13,128)
General and administrative expenses	(1,796,032)	(554,766)
Income from operations	14,167,591	4,419,263
Other income and (expense)	(46,749,191)	(962,560)
Income (loss) before income taxes and non-controlling interest	(32,581,600)	3,456,703
Provision for income tax	(2,243,088)	(105,249)
Net income (loss)	(34,824,688)	3,351,454
Net income attributable to non-controlling interest		(351,849)
Net Income (loss) attributable to Sino Clean Energy Inc.	$ (34,824,688)	$ 2,999,605

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Revenues. Our revenue is derived from the sale of CWSF. For the year ended December 31, 2009, we had revenues of $46,012,353 as compared to revenues of $14,253,989 for the year ended December 31, 2008, an increase of 222%. This significant increase is primarily attributable to the increased output from the new production lines added throughout 2009, which led to an increase in sales to existing and new customers. The annual production capacity as of December 31, 2009 was 650,000 metric tons, as compared to 100,000 metric tons as of December 31, 2008. As of December 31, 2009, we had 30 customers under CWSF supply agreements totaling approximately 600,000 metric tons per year, as compared to 27 customers totaling approximately 400,000 metric tons per year as of December 31, 2008. We believe that our sales and number of customers in 2009 as compared to 2008 are indicative of the growing market acceptance of CWSF.

Cost of Goods Sold. Cost of goods sold, consisting of raw materials, direct labor and manufacturing overhead, and depreciation of plant and machinery, were $28,922,846 for the year ended December 31, 2009, as compared to $9,266,832 for the year ended December 31, 2008, an increase of 212%. The large increase in cost of goods sold is in line with the increase in sales. Gross profit margin improved from 35% in 2008 to 37% in 2009 as a result of higher selling prices for our CWSF and a lower average cost per metric ton of coal. As a result of the new production line added in 2009, depreciation of plant and machinery for the year 2009 was $1,504,559, as compared to $207,674 in 2008.

Selling Expenses. Selling expenses totaled $1,125,884 for the year ended December 31, 2009, as compared to $13,128 for the year ended December 31, 2008, an increase of 8,476%. This increase is mainly due to an increase in transportation costs resulting from the growth of our business which amounted to $1,071,046. For the year ended December 31, 2008, the transportation cost of CWSF was paid by our customers and for the majority of the year ended December 31, 2009, we included the transportation cost of CWSF in our selling price.

General and Administrative Expenses. General and administrative expenses totaled $1,796,032 for the year ended December 31, 2009, as compared to $554,766 for the year ended December 31, 2008, an increase of approximately 224%. This increase is primarily attributable to the expansion of our operations and increased public company expenses.

Other Income (Expenses). Other income (expenses) consists primarily of rental income, interest income and is net of the stock-based cost of our private placement, changes in the fair value and the extinguishment of certain derivative liabilities, and expenses related to the shares of common stock held by our chief executive officer and placed in escrow in connection with our September 2008 financing transaction. For the year ended December 31, 2009, other expenses were $46,749,191, as compared to $962,560 for the year ended December 31, 2008, an increase of 4,756%. The increase in other expenses is attributable to the derivative liabilities of convertible notes and warrants and the cost of private placement of $37,747,227 related to our July 2009 financing transaction.

Provision for income taxes. For the years ended December 31, 2009 and 2008, our provision for income taxes was $2,243,088 and $105,249, respectively. The increase in income taxes reflects the increase in taxable income from our operations in China. For the years ended December 31, 2009 and 2008, our effective tax rate was 7% and 3%, respectively, of income (loss) before provision for income taxes. In 2009 and 2008, our effective tax rate was increased by 48% and 12%, respectively, due to expenses related to financings and derivatives that are classified as permanent differences. Additionally, in 2009 and 2008, our effective tax rate was reduced by 3% and 31%, respectively, for certain tax holidays we enjoy in the PRC.

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Net Income (Loss). We had net a net loss of $34,824,688 for the year ended December 31, 2009, as compared to net income of $2,999,605 for the year ended December 31, 2008. The decrease in net income is primarily attributable to incurring of derivative liabilities in other expenses related to our July 2009 financing transaction.

Recent Financing Transactions

2008 Financings

In September 2008, we issued an aggregate of $1,335,650 of 18% unsecured convertible debentures (the "Debentures") and issued warrants to purchase up to 890,433 shares of our common stock (the "Series A Warrants") in two private placements. The Debentures bore interest at 18% per annum and matured in one year. The holders of the Debentures had the right at any time to convert all or part of the outstanding principal amount of the Debentures and any accrued and unpaid interest into shares of our common stock at the initial conversion price of $1.50 per share. In 2009, all of the Debentures were converted. The Series A Warrants are exercisable until October 31, 2011 at the initial exercise price of $1.50 per share, subject to adjustments and limited to no lower than $0.50 per share.

2009 Financings

In July 2009, we issued an aggregate of $11,592,000 of 10% senior secured convertible notes (the "Notes") and issued warrants to purchase up to 3,050,526 shares of our common stock (the "Series B Warrants"). The Notes bore interest at a rate of 10% per annum with a three year maturity date. The holders of the Notes had the right at any time to convert all or part of the outstanding principal amount of the Notes and any accrued and unpaid interest into shares of our common stock at the initial conversion price of $1.90 per share. In the first quarter of 2010, all of the Notes were converted into 5,377,368 shares of our common stock.

The Series B Warrants are exercisable at the initial exercise price of $2.85 per share, subject to a full ratchet anti-dilution adjustment in the event that we issue additional equity, equity linked securities or securities convertible into equity, at a purchase price less than the then applicable conversion price or the exercise price.

Quarterly Results of Operations

We have consistently expanded production capacity since commencing production in 2007 in order to increase production volume to meet demand in our current markets. During the period of the eight quarters from October 1, 2008 to September 30, 2010, our production capacity increased from 100,000 metric tons to 850,000 metric tons per year. As a result of increased production volume, our revenue, growth margin and adjusted earnings have increased with compound quarterly growth rate of 22.6%, 23.1% and 19.9%, respectively.

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Sino Clean Energy Inc. and Subsidiaries
Consolidated Statements of Income and Other Comprehensive Income
(Amounts expressed in U.S. Dollars)
(Unaudited)

	Three Months ended							
	September 30, 2010	**June 30, 2010**	**March 31, 2010**	**December 31, 2009**	**September 30, 2009**	**June 30, 2009**	**March 31, 2009**	**December 31, 2008**
Revenue	$ 24,913,134	$ 24,149,761	$ 24,509,004	$ 19,029,780	$ 10,889,796	$ 8,314,500	$ 7,778,277	$ 4,872,749
Cost of goods sold	(15,269,720)	(14,779,016)	(14,400,177)	(11,227,341)	(6,812,469)	(5,534,929)	(5,348,107)	(3,039,226)
Gross profit	9,643,414	9,370,745	10,108,827	7,802,439	4,077,327	2,779,571	2,430,170	1,833,523
Selling expenses	1,156,147	1,136,019	911,079	703,479	416,585	2,261	3,559	5,257
General and administrative expenses	579,837	626,053	719,182	343,057	471,664	432,412	548,899	22,840
Income from operations	7,907,430	7,608,673	8,478,566	6,755,903	3,189,078	2,344,898	1,877,712	1,805,426
Other income (expenses)								
Total other income (expenses)	(946,659)	2,872,713	13,732,560	(11,585,458)	(33,641,096)	(1,499,687)	(22,950)	(1,204,777)
Income before provision for income taxes	6,960,771	10,481,386	22,211,126	(4,829,555)	(30,452,018)	845,211	1,854,762	600,649
Provision for income taxes	1,349,424	1,540,627	1,750,505	1,187,370	463,050	303,382	289,286	80,470
Net income (loss)	**$ 5,611,347**	**$ 8,940,759**	**$ 20,460,621**	**$ (6,016,925)**	**$ (30,915,068)**	**$ 541,829**	**$ 1,565,476**	**$ 520,179**
Weighted average number of shares								
Basic	16,703,844	16,557,000	12,851,265	10,379,897	10,041,910	9,532,061	9,219,471	9,218,175
Diluted	18,780,537	19,216,041	14,933,797	10,379,897	10,041,910	9,910,926	9,275,123	9,537,106
(Loss) Income per common share								
Basic	$ 0.34	$ 0.54	$ 1.59	$ (0.58)	$ (3.08)	$ 0.06	$ 0.17	$ 0.06
Diluted	$ 0.30	$ 0.47	$ 1.37	$ (0.58)	$ (3.08)	$ 0.05	$ 0.17	$ 0.05
Non-GAAP Adjusted Earnings								
Net Income (loss)	$ 5,611,347	$ 8,940,759	$ 20,460,621	$ (6,016,925)	$ (30,915,068)	$ 541,829	$ 1,565,476	$ 520,179
Non-GAAP adjustments:								
Amortization of discount on convertible notes			8,601,975	68,206	3,120,954	423,687	329,338	348,363
Value of shares issued for bonus interest			1,864,701					
Expense related to escrow shares				9,830,190	1,054,548	120,166	120,167	676,466
Gain on extinguishment of derivative liability			(28,404,181)	(3,675,963)	(2,381,333)	(989,260)		
Change in fair value of derivative liabilities	970,813	(2,862,263)	4,239,929	4,533,875	7,035,248	1,779,968	(578,978)	
Cost of private placement				182,272	24,794,842			
	$ 6,582,160	**$ 6,078,496**	**$ 6,763,045**	**$ 4,921,655**	**$ 2,709,191**	**$ 1,876,390**	**$ 1,436,003**	**$ 1,545,008**

Non-GAAP Adjusted Earnings (unaudited)

Non-GAAP Financial Measure

Non-GAAP adjusted earnings are not a measure of financial performance under U.S. GAAP, and should not be considered in isolation or as an alternative to net income (loss). We define non-GAAP adjusted earnings as net income (loss) excluding charges for the change in derivatives, gains on the extinguishment of derivatives, cost of private placements, which represents the excess of the fair value of the derivative liability created upon issuance of the notes over the amounts received, shares issued for bonus interest, expenses related to escrow shares and other non-cash financing costs. We believe non-GAAP adjusted earnings is an important measure of operating performance because it allows management, securities analysts, investors and others to evaluate and compare our core operating results to other companies in our industry, including our return on capital and operating efficiencies, from period to period by removing the impact of our costs of private placements, derivative liabilities and other non-cash financing costs. Other companies may calculate non-GAAP adjusted earnings differently, and therefore our non-GAAP adjusted earnings may not be comparable to similarly titled measures of other companies.

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Liquidity and Capital Resources

For the nine-month period ended September 30, 2010, we generated $21,277,585 from operating activities, as compared to $5,103,069 that we generated from operating activities for the nine-month period ended September 30, 2009. This increase is primarily due to the increase in sales proceeds.

For the nine-month period ended September 30, 2010, we used $4,861,342 in investing activities, of which $2,621,605 was used in the purchase of property, plant and equipment, as compared to the net cash used in investing activities of $4,303,540 for the nine-month period ended September 30, 2009.

For the nine-month period ended September 30, 2010, we used $227,701 in financing activities, primarily due to prepayment of deferred offering cost.

As of September 30, 2010, we had cash and cash equivalents of $34,348,096. Our total current assets were $44,974,816 and our total current liabilities were $24,801,174 which resulted in a net working capital of $20,173,642.

As of September 30, 2010, we had made an initial deposit of approximately $555,000 to purchase approximately 5 acres of land and a production factory for approximately $5,550,000 (RMB 37,200,000). The balance of the purchase price will be due when refurbishment of the factory is complete which is expected to occur by the end of December 2010. At September 30, 2010, we had made an initial deposit of approximately $1,612,000 for the purchase of two production lines with capacity for processing 300,000 tons of CWSF annually in Guangdong costing a total of approximately $5,372,000 (RMB 36,000,000). The balance of the purchase price will be due when the productions lines are completed and in service, which is expected to occur by the end of December 2010.

We believe that we have sufficient cash flow to meet our obligations on a timely basis in the foreseeable future.

For the year ended December 31, 2009, we generated cash of $9,691,888 from operating activities, as compared to $4,795,905 that we generated from operating activities for the year ended December 31, 2008. This increase is primarily due to the increase in revenue.

For the year ended December 31, 2009, we used $4,389,843 in investing activities, as compared to $5,319,546 that we used in investing activities for the year ended December 31, 2008. This decrease of cash used in investing activities is mainly due to the fact that most of the payments for purchases of equipment and machinery for our new production lines were made in 2008.

For the year ended December 31, 2009, we generated $9,082,787 from financing activities, as compared to $1,418,375 that we generated in financing activities during the year ended December 31, 2008. This increase is due mainly to the proceeds raised from the issuance of convertible notes.

As of December 31, 2009, we had cash of $18,302,558. Our total current assets were $28,806,180 and our total current liabilities were $21,075,784, which resulted in net working capital of $7,730,396. We had capital expenditure commitments outstanding as of December 31, 2009 in the amount of $4,071,351 in relation to the purchase of machinery. We believe that we have sufficient cash flow to meet our obligations on a timely basis in the foreseeable future.

As of December 31, 2009, we had outstanding $10,217,000 of principal amount of our convertible notes. Subsequent to December 31, 2009, all the convertible noteholders converted these notes into

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5,377,368 shares of our common stock pursuant to the original securities purchase agreement and note.

Capital Expenditures

We believe that our existing cash, cash equivalents, cash flows from operations, and the proceeds from this offering will be sufficient to meet our presently anticipated future cash needs and to meet our capital expenditure plans. We may, however, require additional cash due to changing business conditions or other future developments, including any investments or acquisitions we may decide to pursue.

We intend to expand our operations as quickly as reasonably practicable to capitalize on the demand for our products. We intend to expand our annual capacity to 1,850,000 metric tons by developing new production capacity in Guangxi and Guangdong Provinces. We estimate that we will require $34.5 million to meet our capital expenditure program over the next twelve months. We regularly review our cash funding requirements and attempt to meet those requirements through a combination of cash on hand, cash provided by operations and public or private financings. We believe that we can continue to meet our cash funding requirements for our business in this manner over the next twelve months.

We had capital expenditure commitments outstanding as of September 30, 2010 in the amount of $10,922,000 in relation to the purchase of machinery.

Contractual Obligations

We have certain commitments as of September 30, 2010 that include future payments. We have presented below a summary in order to assist in the review of this information within the context of our consolidated financial position, results of operations, and cash flows.

Payments Due by Period

	Total	**Less than 1 year**	**1 3 Years**	**3 5 Years**	**5 Years +**
Contractual obligations:					
Capital expenditure commitment(1)	$ 10,922,000	$ 10,922,000	$	$	$
Operating leases(2)	320,389	35,272	70,544	70,544	144,029
Coal inventory purchase agreement	12,105,045	12,105,045			
Debt repayment and interest on debt(3)					
Total contractual obligations:	$ 23,347,434	$ 23,062,317	$ 70,544	$ 70,544	$ 144,029

(1) Capital expenditure commitments include the purchase of machinery for our production of CWSF.

(2) Operating lease amounts include minimum lease payments under our non-cancelable operating leases for office premises and production plants. The amounts presented are consistent with contractual terms and are not expected to differ significantly, unless a substantial change in our headcount requires us to exit an office facility early or expand our occupied space.

(3) We have excluded from this table $10,217,000 of convertible notes that were outstanding as of December 31, 2009 and have been subsequently converted into 5,377,368 shares of our common stock.

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Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our investors.

Inflation

We believe that inflation has not had a material effect on our operations to date.

Critical Accounting Policies and Estimates

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

Revenue Recognition

Sales are recognized when the following four revenue criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured. Revenue is presented net of value added tax ("VAT"). In our revenue arrangements, physical delivery is the point in time when customer acceptance occurs since title and risk of loss are transferred to the customer. No return allowance is made as products are normally not returnable upon acceptance by the customers.

Accounts receivable

Accounts receivables are recognized and carried at original invoiced amount less an allowance for any uncollectible accounts. We use the aging method to estimate the valuation allowance for anticipated uncollectible receivable balances. Under the aging method, bad debts determined by management are based on historical experience as well as the current economic climate and are applied to customers' balances categorized by the number of months the underlying invoices have remained outstanding. The valuation allowance balance is adjusted to the amount computed as a result of the aging method. When facts subsequently become available to indicate that an adjustment to the allowance should be made, this is recorded as a change in estimate in the current year. As of September 30, 2010, accounts receivable were net of zero allowances.

Derivative Financial Instruments

We evaluate all of our financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, we use a Monte-Carlo simulation model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified on the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Stock-based Compensation

We periodically issue stock options and warrants to employees and non-employees in capital raising transactions, for services and for financing costs. Stock-based compensation is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period. Options vest and expire according to terms established at the grant date. As of September 30, 2010, we did not have any equity compensation plans in effect, although our board of directors may approve from time to time the issuance of equity compensation to our employees as additional compensation outside an equity compensation plan.

We estimate the fair value of stock options and warrants using the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of options that have no vesting restrictions and are fully transferable. This model requires the input of subjective assumptions, including the expected price volatility of the underlying stock and the expected life of stock options. Projected data related to the expected volatility of stock options is based on the average volatility of the trading prices of comparable companies and the expected life of stock options is based upon the average term and vesting schedules of the options. Changes in these subjective assumptions can materially affect the fair value of the estimates, and therefore the existing valuation models do not provide a precise measure of the fair value of our employee stock options.

We estimate the fair value of shares of common stock issued for services based on the closing price of our common stock on the date shares are granted. For periods prior to the consummation of our 2006 share exchange transaction, there was no readily available market quotations for our shares of common stock and, as such, we used alternative methods to value shares of our common stock including valuations based upon the conversion price per share of common stock of our convertible notes and the sale price of units consisting of one share of our common stock and warrants to purchase one share of common stock, which management believes were the best indicators of the fair value of our common stock.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On December 5, 2008, we dismissed AGCA, Inc. (formerly known as Yu & Associates CPA Corporation), as our independent registered public accounting firm. The reports of AGCA on our financial statements for the year ended December 31, 2007 contained no adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. The decision to change independent accountants was approved by our board of directors.

We had no disagreements with AGCA on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which if not resolved to the satisfaction of AGCA, would have caused AGCA to make reference to the subject matter of such disagreements in its report on our financial statements for such period. During the fiscal year end December 31, 2007, there were no reportable events as defined under Item 304(a)(1)(v) of Regulation S-K adopted by the SEC.

AGCA provided us with a letter addressed to the SEC stating that it agreed with the above statements. This letter was filed as an exhibit to our Current Report on Form 8-K, which was filed with the SEC on December 9, 2008.

On December 5, 2008, we appointed Weinberg & Company, P.A. as our independent registered accounting firm. The appointment of Weinberg & Co. was approved by our board of directors.

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BUSINESS

Company Overview

We are a leading producer of clean coal heating and energy solutions for residential, commercial and industrial uses in China. We produce and distribute coal water slurry fuel ("CWSF"), which is a liquid fuel that consists of fine coal particles suspended in water, mixed with chemical additives, and is primarily used to fuel boilers and furnaces to generate steam and heat for both residential / commercial heating and industrial applications. CWSF is an economic and environmentally friendly alternative to oil and natural gas and provides many benefits over coal briquettes, including increased burn-off rates, improved thermal efficiency, and reduced emissions. We believe that the combination of China's heavy reliance on coal for heat and energy, its extensive coal reserves, and increased government attention to clean coal technologies, make CWSF an ideal alternative for cleaner heat and energy production in China.

China's economic growth over the last four decades has led to a rapid increase in energy demand. According to Frost & Sullivan, China accounted for 17.7% of global primary energy demand in 2008 and will overtake the United States as the world's largest consumer of energy in 2011. China is the largest producer and consumer of coal in the world, making it much more reliant on coal than other developed nations, as it is used extensively not only for power generation, but also for industrial applications and residential heating. Coal is the most widely used energy source in China for heating and electric power generation due to its abundance, broad geographic distribution, and mature power conversion infrastructure. According to the National Bureau of Statistics of China, coal is expected to be used for approximately 67% of total energy consumption in China in 2010 and represents more than 90% of estimated domestic fossil fuel reserves. Although significant progress has been made by Chinese central and provincial governments to utilize alternative sources of energy such as hydro, nuclear, solar and wind power, significant obstacles remain in establishing alternative energy to satisfy a significant portion of China's energy requirements primarily due to their relatively prohibitive capital costs, especially in light of the well established coal power conversion infrastructure that is already in place in China. According to Frost & Sullivan, overall CWSF demand in China is expected to grow at a compounded annual growth rate ("CAGR") of 24.7% from 2008 to 2014.

Our business was originally established in August 2002 to focus on the production and distribution of copolymer resin products. In 2004, we identified an attractive opportunity to enter the CWSF market due to the strong government push for clean coal technologies and the resulting market demand for more efficient and cleaner uses of coal. In April 2006, we decided to focus solely on the research, development, production, marketing and sale of CWSF and accordingly phased out our copolymer resin business in January 2007. We obtained our first sales contracts for CWSF in early 2007, completed the installation of our first 100,000 metric ton CWSF production line in June 2007, and commenced mass production and distribution of CWSF in July 2007. We have grown substantially in recent years by adding production capacity at existing and new locations, and are currently fully utilizing our in-place annual production capacity of 850,000 metric tons of CWSF.

We primarily use washed coal to produce CWSF, which we procure from local coal mines. We have established strong relationships with our suppliers and our ability to purchase large quantities of raw materials has allowed us to achieve favorable pricing and delivery terms. We sell our CWSF exclusively in China to residential complex development management companies, commercial businesses, industrial users, and government organizations that use CWSF predominantly for residential/commercial heating and industrial applications. Our customers adopt CWSF as a substitute for oil, natural gas and coal briquettes in their furnaces or boilers. We typically enter into three to five year framework agreements with our customers that provide guidance on CWSF sales volumes

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and prices. We have framework agreements in place with approximately 90% of our customers. Based on our experience, the CWSF consumption volume of any given boiler does not change materially from year to year. Once established, the customer base for CWSF is very stable, as consumption patterns are highly predictable, and the cost to switch CWSF boilers to other fuels is prohibitively expensive. Our strong reputation in the CWSF industry in China, together with our established track record for consistently delivering high quality products in large quantities, has enabled us to expand our customer base over time. As of September 30, 2010, we were servicing a total of 43 customers in Shaanxi and Liaoning Provinces.

Company Strengths

Exclusive focus on CWSF, which has significant advantages over coal briquettes and other traditional fossil fuels

CWSF has several advantages over coal briquettes and other traditional fossil fuels, including:

- it is more energy efficient;
- it creates significantly less pollution;
- it is a cheaper source of energy;
- it is cleaner to transport and store; and
- it is safer to handle.

Compared to coal briquettes, CWSF has a higher burn-off rate (the percentage of combustible mass in a given unit of solid fuel mass) and thermal efficiency (the percentage of useful work in the output of total energy), which reduces carbon discharge and increases the utilization of the coal input. According to Frost & Sullivan, CWSF emits 80% less sulfur dioxide than coal briquettes and 49% less sulfur dioxide than oil. Depending on the geographic area, we believe CWSF may be approximately 50% cheaper than oil and approximately 30% cheaper than natural gas on a per-unit-of-energy basis. Compared to coal briquettes, CWSF is cleaner to transport and store, as it can be transmitted by tank trucks and through pipelines and can be stored for up to one year. CWSF is safer to handle than other traditional fossil fuels, as CWSF's relatively high burning point of over 800 degrees Celsius makes it more resistant to explosion.

The CWSF industry has strong government support and is growing rapidly

In China's 2010 Report on Central and Local Budgets, the Chinese government states that it has budgeted approximately US$12 billion for energy conservation and pollution reduction and to promote the development of low-carbon technologies. Since China began pursuing the development of CWSF technology in the 1980's, demand for CWSF has increased, logistics costs have been reduced, and suppliers have implemented better quality controls to ensure a more consistent product. According to Frost & Sullivan, in 2008, China's annual CWSF demand was 15.9 million metric tons, and CWSF was being used in 700 industrial furnaces and in hundreds of industrial kilns as a replacement for oil, natural gas and coal briquettes. According to Zhongjing Zongheng Economy Research, there are approximately 600,000 traditional fossil fuel burning industrial boilers and kilns currently installed in China, with approximately 100,000 requiring replacement or major repairs each year. We believe there is significant opportunity for the CWSF industry to fill the void left by older coal briquette burning boilers that are being phased out by legislation and obsolescence. According to Frost & Sullivan, overall CWSF demand is expected to grow at a CAGR of 24.7% from 2008 to 2014. Furthermore, we believe that a significant opportunity exists for third-party CWSF producers, which are expected to increase their market share from 13% in 2008 to 24% in 2011.

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Dominant market position with a proven product and technology that is in full scale commercial production

Having commenced operations in 2006, we have established a first mover advantage as one of the first commercial CWSF producers in China and, to our knowledge, the only pure-play publicly listed CWSF producer in the world. We obtained our first sales contracts for CWSF in early 2007, completed the installation of our first CWSF production line in June 2007, and commenced mass production and distribution of CWSF in July 2007. We believe that there are currently 40 to 50 active CWSF suppliers in China, however, most are much smaller than us, with third party sales volumes of less than 100,000 metric tons. We are the largest third-party CWSF producer in China as measured by third party sales volume for the first half of 2010, and we currently have in-place CWSF production capacity of 850,000 metric tons. Third party CWSF producers do not include entities that produce CWSF in-house for their own consumption or, parties that import CWSF for sale. We aim to increase our annual production capacity to 1,850,000 metric tons through the expansion of production capacity at existing facilities and the development of new facilities throughout China. For the year ended December 31, 2009, we had revenue and income from operations of approximately US$46 million and US$14 million, respectively.

Exclusive Agreements with Select Strategic Partners

We have agreements in place with strategic partners who we believe are highly complementary to our CWSF production business. We have a sales agency agreement with Qingdao Haizhong Enterprise Co., Ltd. ("Haizhong Boiler"), a CWSF boiler manufacturer with an estimated 78% share of the Chinese CWSF boiler market (according to Beijing Zhongjing Zhongheng Information and Consulting Center, Haizhong Boiler's market share was determined on December 30, 2009 and was valid until October 31, 2010), whereby we act as the exclusive distributor for Haizhong Boiler's CWSF boilers in Shaanxi Province. Following the success of the sales agency agreement in Shaanxi Province, we entered into an exclusive nationwide strategic partnership agreement with Haizhong Boiler pursuant to which Haizhong Boiler focuses on selling CWSF boilers and in some markets operating heat supply plants, while we focus on supplying the requisite CWSF. We have an exclusive agreement with Shenyang Haizhong Heat Resource Co., Ltd, an unrelated third-party municipal heat supplier, to supply CWSF for residential and commercial heating in Shenyang. The current amount of CWSF required is approximately 300,000 metric tons and is estimated to increase to 850,000 metric tons by the end of 2012. We also have an agreement with Tongchuan City Investment and Development Co., Ltd. to develop a new heat supply company for the purpose of providing heating for the new district of Tongchuan. It is expected that 15 heat supply plants will need to be built and the requisite CWSF will be supplied by us. Suo'ang New Energy is expected to retain a 15% stake in the Tongchuan heat supply company.

Established relationships with customers and suppliers which provide visibility on long term cash flows

Since obtaining our first sales contracts for CWSF in January 2007, we have expanded our customer base to a point where we were serving a total of 43 customers as of September 30, 2010. We have developed a strong reputation in the CWSF industry in China, which, together with our established track record for consistently delivering high quality products in large quantities, has enabled us to maintain and expand our customer base. As the only CWSF producer in Shaanxi Province, we are greatly insulated from the risk of customer attrition to competing suppliers in that area. Since commencing commercial operations in 2007, we have achieved a 100% customer retention rate. Our customers include residential developers, commercial customers, industrial customers, and government organizations that use CWSF primarily for industrial uses and residential/commercial heating applications as a substitute for oil, natural gas or coal briquettes. We have entered into long

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term framework agreements with approximately 90% of our customers, which set out guidance on quantities and prices for CWSF, typically with a term of three to five years. We have established strong relationships with our suppliers, and our ability to purchase large quantities of raw materials has allowed us to achieve favorable pricing and delivery terms.

Experienced management team with a proven track record

We have a well seasoned and experienced senior management team with significant CWSF industry experience that we believe will enable us to execute on our expansion strategy. Our CEO, Mr. Baowen Ren, is a prominent figure in China's CWSF industry with over seven years' experience in CWSF research, development and sales. As a member of the China CWSF Research Center, the China Association of Environmental Protection Industry, and the China Association of Low-Carbon Economy, Mr. Ren is very familiar with China's clean energy policies, regulations, and directions, and the role that CWSF plays within China's clean coal technology plan. Since 2005, Mr. Ren has built the largest CWSF production base in northwest China. In 2008, Mr. Ren issued the paper "The Development of CWSF under the Movement of National Energy Conservation and Emission Reduction", which was adopted by the National CWSF Promotion Work Conference Paper Collection. Mr. Ren has received numerous accolades and acknowledgements for his achievements and success, including a designation as "Shaanxi Top 100 Entrepreneur". Mr. Peng Zhou, the chief operating officer of Shenyang Energy, brings strong operational expertise in CWSF industry. He is an expert in coal resources in west China, and has substantial knowledge of CWSF technologies and markets in China. He has managed operations in multiple industries for more than 10 years. His expertise and dedication to CWSF has significantly contributed to our strong growth. Our CFO, Ms. Wendy Fu brings more than twenty years of professional financial and accounting experience with public companies and accounting firms, including former roles as the CFO of China Shenghuo Pharmaceutical Holdings Inc. (AMEX: KUN), Vice President of Finance at Shengdatech, Inc. (Nasdaq: SDTH) and Assistant Finance Controller at Wal-Mart China.

Growth Strategy

Our objective is to be the leading supplier of CWSF in China. Key elements of our growth strategy include:

Pursue organic growth in existing markets

At the beginning of 2009, we had in-place CWSF production capacity of 350,000 metric tons, 100% of which was from our Tongchuan facility. In October 2009, we brought our 300,000 metric ton per annum Shenyang facility on-line, bringing aggregate annual in-place production capacity to 650,000 metric tons. Having added an additional 200,000 metric tons of capacity at our Tongchuan facility in January 2010, our run-rate production capacity increased to 850,000 metric tons per annum. For the year ended December 31, 2009, we sold approximately 456,000 metric tons of CWSF, representing substantially all of our production in that year. During the first nine months of 2010, we sold approximately 685,000 metric tons of CWSF. We believe that there is significant organic growth potential embedded within our current operations as we continue to bring new production capacity on-line in both of our existing markets. Our sales and marketing team consists of 12 in-house personnel which sell our CWSF to customers located mainly within a radius of 200 kilometers of our production facilities. We plan to further expand our customer base and market share by increasing our sales and service personnel.

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Leverage strategic partnership with Haizhong Boiler

In order to increase the adoption of CWSF technology, we have established collaborative market development programs with Haizhong Boiler, which is China's largest CWSF boiler and furnace equipment manufacturer, which we believe will give us the ability to effectively market our CWSF products to prospective customers. We have established a sales agency agreement with Haizhong Boiler, pursuant to which we act as the exclusive distributor for Haizhong Boiler's CWSF boilers in Xi'an and Tongchuan in Shaanxi Province, and receive a referral fee of approximately 20% of each boiler sold by us within the province. Following the success of the sales agency agreement in Shaanxi province, we entered into an exclusive nationwide strategic partnership agreement with Haizhong Boiler pursuant to which Haizhong Boiler focuses on selling CWSF boilers, and in some markets operating heat supply plants, while we focus on supplying the requisite CWSF.

Capitalize on strong government support for CWSF

As China's economy continues to grow at a rapid pace, the demand for energy will continue to increase, placing further strain on China's energy infrastructure. Increasing urbanization rates and improved living standards are expected to increase the consumption of energy as the demand for residential heating continues to rise. Coal is the largest fuel source for heating and electric power generation in China, comprising approximately 67% of overall energy production. As China has low-cost, abundant and geographically distributed coal reserves and a mature coal-to-energy conversion infrastructure, it is expected that coal will continue to be one of the most important sources of energy for China in the foreseeable future and as a result, we believe that any solution to China's pollution problems must include clean coal technologies, such as CWSF. We believe that China's increased focus on the environment and its extensive coal reserves make CWSF an attractive alternative for cleaner energy production, which would drive demand for CWSF products over time. CWSF has been listed as a key scientific and technological project in each of China's Five-Year Plans since 1981, and in several other major sustainable development policy initiatives. Many provinces and cities across China have adopted specific and quantifiable targets, plans, policies and incentives to promote the usage of CWSF, including financial subsidies to CWSF consumers relating to boiler installations and incentives for attaining threshold levels of CWSF consumption. We have entered into an agreement with the Tongchuan municipal government to develop a network of 15 new residential heat supply plants over the next five to seven years that utilize our CWSF as a fuel source.

Grow through expansion and acquisitions in other regional markets

We plan to increase our CWSF production capacity through the construction of new facilities and the acquisition of existing CWSF production facilities in new geographic regions. Our geographic expansion plans will initially focus on Nanning, Guangxi Province and Guangdong Province. In addition, we plan to expand the production capacity at our current location in Shenyang, Liaoning Province. We expect that such growth initiatives will increase our aggregate annual CWSF production capacity to 1,850,000 metric tons.

Coal-Water Slurry Fuel

CWSF is a fuel that consists of fine coal particles suspended in water, mixed with chemical additives. By mass, CWSF is typically comprised of 70% fine dispersed coal particles, 29% water and 1% chemical additives. The presence of water in CWSF reduces harmful emissions into the atmosphere during the combustion process, as CWSF's water content can be turned into water vapor, which decreases the temperature within the boiler, thereby inhibiting the production of oxynitride. CWSF is burned in a liquid state within a boiler which is specifically designed for the combustion of

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CWSF. When burned, CWSF is pumped from a storage chamber into a duct which carries the fuel to an atomizer. The atomizer injects a fine spray into the combustion chamber in a manner similar to that used in oil boilers. This method of injection increases the burn-off rate and thermal efficiency of CWSF, making it much more efficient than traditional coal briquettes.

Coal particles in CWSF typically have a size of less than 200 to 300 microns and can be used in several different applications. Smaller-particle CWSF is more versatile in a broader range of potential applications, however, smaller CWSF is more difficult to manufacture. CWSF particles as small as 20 microns have been demonstrated to be viable substitutes for oil and natural gas in power plants. In the largest particle form, CWSF is a viable substitute for oils used to produce steam in boilers. At 80 microns or less, CWSF can be used as a co-fuel or substitute fuel in diesel engines. Currently, we are capable of producing CWSF with a particle size that is as fine as 20 to 30 microns. Although smaller particle CWSF has a broader range of applications, there is currently no significant price difference compared to larger particle CWSF.

CWSF can be stored for up to a year. By converting the coal into a liquid form, the delivery and dispensation of the fuel can be simplified. It is stored in tanks and can be transported by tank trucks and pipes similar to oil or natural gas, which is an advantage over coal briquettes. Furthermore, CWSF's water content increases its burning point which makes it safer to store and cleaner to transport than coal briquettes.

Benefits of CWSF

As CWSF's primary raw material is coal, it is a very competitive alternative to oil and natural gas on a per unit of energy basis, primarily because of the relatively low cost of coal in China. Depending on the geographic area, CWSF may be approximately 50% cheaper than oil and approximately 30% cheaper than natural gas on a per unit of energy basis. According to Frost & Sullivan, in 2009, the cost for oil in China was RMB 426 per billion calories and the price of natural gas was RMB 312 per billion calories, whereas the cost of CWSF was RMB 211 per billion calories. Due to China's ongoing support for research and development of CWSF and its abundant coal resources, CWSF is expected to maintain a price advantage over oil and natural gas.

Compared to coal briquettes, CWSF is significantly less harmful to the environment. CWSF has a higher burn-off rate and thermal efficiency than coal briquettes, thereby increasing the utilization of the input coal, which reduces sulfur dioxide, nitrogen oxide and soot. Sulfur dioxide is predominately captured by CWSF boilers and furnaces during the combustion process. Based on data from Frost & Sullivan, the use of CWSF reduces sulfur dioxide emissions by over 80% compared to burning coal briquettes and 49% compared to burning oil while generating the same amount of energy. As China's environmental regulations become more stringent, CWSF is expected to gradually replace coal briquettes in many industrial applications. The following charts illustrate the differences between coal briquettes, oil, natural gas and CWSF on an efficiency and emissions basis.

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Fuel Performance Comparison

		Coal Briquette	Oil	Natural Gas	CWSF
Operating assumptions					
Energy per unit (kcal/t)		6.5 M	10.0 M	9,000/m3	4.5 M
Burn-off rate		65%	99%	99%	98%
Thermal efficiency		65%	90%	90%	86%
Energy generated (kcal/t)		2,746,250	8,910,000	8,019 per m3	3,792,600
Economics					
Market price of fuel (RMB/t)		680	3,800	2.5 (RMB/m^3)	800
End user cost (RMB/Bcal)		248	426	312	211
Emissions					
SO_2	Emissions (kg)	20.00	26.00	0.00	5.60
	Emission Index*	7.28	2.92	0.00	1.48
NO_x	Emissions (kg)	7.64	2.31	0.27	n/a
	Emission Index*	2.78	0.26	0.03	n/a
Soot	Emissions (kg)	68.53			48.00
	Emission Index*	24.95			12.66

* "Emission Index" is "Emissions" / "Energy generated". Source Frost & Sullivan

CWSF is burned in boilers that are specially designed for its combustion. Although it is possible to retrofit oil burning boilers to be CWSF compliant, most adopters of CWSF elect to install new CWSF boilers due to their superior operating efficiency and lower on-going maintenance costs relative to retrofitted boilers. Based on previous experience, management believes that the cost to purchase and install a new CWSF boiler ranges from approximately $150,000 to $750,000, depending on output capacity, which is approximately 15% to 20% higher than the capital costs for purchasing and installing traditional coal briquette boilers. It is typically not economical to retrofit coal briquette or natural gas burning boilers.

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Industry Overview

Energy and Coal

China's economic growth over the past four decades has led to a rapid increase in energy demand. According to Frost & Sullivan, China accounted for 17.7% of global energy consumption in 2008, and is expected to overtake the United States as the world's largest energy consumer in 2011.

Energy Consumption by Region (Global), 2008

Source: Frost & Sullivan, BP Statistical Review of World Energy (June 2009)

(1) Other Americas include Canada, Mexico, Argentina, Brazil, Chile, Colombia, Peru, Venezuela, and so on.

(2) Other Asia Pacific include Australia, Bangladesh, China Hong Kong, China Taiwan, India, Indonesia, Japan, Malaysia, New Zealand, and so on.

Globally, coal accounted for approximately 29% of total energy consumption in 2008. China is the largest producer and consumer of coal in the world, as it uses coal extensively not only for power generation, but also for industrial applications and residential heating. According to the BP Statistical Review of World Energy, China has become the world's largest emitter of carbon dioxide. Coal is the most widely used energy source in China for heating and electric power generation due to its abundance, broad geographic distribution, mature power conversion infrastructure, and low and stable delivery cost. In 2010, coal is expected to account for approximately 67% of overall energy consumption in China.

Energy Structure Forecasts (China), 1980 2010E

Source: Natural Bureau of Statistics of China, Frost & Sullivan

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China has abundant deposits of coal. With proven coal reserves estimated at 114.5 billion metric tons, coal comprises 94.0% of China's proven fossil fuel reserves, while oil and natural gas represent only 5.4% and 0.6%, respectively. Assuming China's fossil fuel reserves continue to be extracted at current rates, China's coal reserves are likely to last another 90 years, whereas oil is expected to be depleted in only 21 years and natural gas in 39 years.

China's Proven Fossil Fuel Reserves, 2008

Source: Frost & Sullivan

Map of China's Coal Resources

Source: Barlow and Jonker (2001)

China's existing energy infrastructure is a major source of the country's pollution and may hinder the country's future economic growth as the increased reliance on coal continues to negatively impact the environment and public health. Pollutants created from the production, transportation and combustion of coal include sulphur dioxide, nitrogen oxide, soot, dust and ash. The World Bank estimates that around 400,000 people in China die each year from pollution-related illnesses. Sulfur dioxide has resulted in acid rain falling on more than 30% of China's total land, ruining croplands, threatening food chains and water systems, and leading to other negative environmental impacts.

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Climate change has already produced visible adverse effects on China's air quality, agriculture, livestock, forests, fresh water resources and coastal regions.

Total Sulfur Dioxide Emissions by Country (1980 2000)

Source: Frost & Sullivan

Alternative Energy and Clean Coal Technologies

Although alternative energies such as hydro, solar and wind power have begun to gain traction as increasingly important components of China's energy infrastructure, they are not expected to replace coal as China's core source of energy. Compared to coal, alternative energy sources generally have longer lead times, higher capital costs, and lower returns on investment relative to coal. Coal is expected to remain an attractive and important component of China's energy infrastructure due to its relative abundance, broad geographic distribution, mature power conversion infrastructure and low and stable delivery cost.

Comparative Assessment of Different Power Sources

Source: Frost & Sullivan

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Developing and utilizing clean coal technology in order to overcome the lower energy efficiency and higher pollution properties of coal briquettes is essential to China's social and economic development. China has stressed the importance of the development of clean coal technology and established the Clean Coal Technology Plan ("CCTP") in 1997, with the objective of improving coal consumption efficiency and reducing environmental pollution. China's CCTP includes four major areas: (i) coal processing (which includes CWSF), (ii) high-efficiency clean combustion of coal, (iii) coal transformation, and (iv) pollution emission control and the disposal of waste materials. China has budgeted approximately US$12 billion in 2010 for energy conservation and pollution reduction. The following table outlines the framework of China's CCTP, which includes 14 major technologies, including CWSF:

Coal Processing	High Efficiency Clean Combustion and Power Generation	Coal Transformation	Pollution Emission Control and Waste Disposal
Coal Preparation	Advanced Burners	Coal Gasification	Flue Gas Cleaning (Desulfuration and Denitration)
Briquettes	Fluid Bed Combustion (FBC)	Coal Liquefaction	Development and Utilization of Coal-Bed Methane
Coal Blending	Integrated Gasification Combined Cycle (IGCC)	Fuel Cells	Comprehensive Utilization of Coal Gangue, Fly Ash and Coal Slurry
Coal Water Slurry Fuel			Industrial Boilers and Furnace

Source: Frost & Sullivan

CWSF Market Development

CWSF originated in the Soviet Union in the 1950's, where experiments were conducted to develop new ways of utilizing coal sludges for power generation. The United States conducted further research into CWSF during the 1973 oil crisis, as it searched for alternatives to crude oil. China started pursuing the development of CWSF technology in the 1980s after CWSF had successfully been developed by the Bayi Coal Mine. After developing local CWSF production capabilities, China's central government set out to promote the increased use of CWSF, where it was used on a trial basis in key national projects and plants and was listed in several key national policy initiatives, including the *"Current Catalogue of Key Industries, Products, and Technologies to be Encouraged"* from 1991 to 1995. China's *"9th Five Year Plan (1996 2000)"* set out a research scope for CWSF and a demonstrative 220 t/h CWSF furnace was built to replace oil burning boilers in power plants. CWSF's prominence was enhanced in China's *"10th Five Year Plan (2001 2005)"*, where the central government released a stand-alone report entitled "2010 Outline for Development of CWSF in China." Following the successful promotion of CWSF, the government has now moved on to encourage its wider application, and has been working with provincial and municipal governments to create local policies and incentives to encourage the use of CWSF. By 2008, China was leading the world in the technological development, production and consumption of CWSF. China's commitment to CWSF has allowed it to overcome issues such as cost (transportation and specialty CWSF furnaces), product quality and a customer base that initially inhibited commercial production.

Furthermore, demand has increased as a result of government subsidies that are being provided to encourage the installation of CWSF boilers and the usage of CWSF as a fuel, and suppliers have implemented better quality controls to ensure a more consistent product.

According to Frost & Sullivan, approximately 13% of CWSF demand was fulfilled by domestic third-party producers in 2008, which is expected to grow to approximately 24% by 2011. Third-party sales are provided by dedicated producers that supply energy producers with CWSF. Given that the in-house market is not externally focused, we expect that increased demand for CWSF will be met through thirty-party sales by dedicated producers such as us. The following charts indicate the breakdown of CWSF by source of supply in 2008 and 2011 respectively. In-house production consists primarily of state-owned coal manufacturers and/or electricity generators that produce CWSF for their own use.

CWSF Market: Breakdown by Source of Supply (China), 2008

CWSF Market: Breakdown by Source of Supply (China), 2011E

Source: Frost & Sullivan

The market demand for CWSF in China in 2008 was 15.9 million metric tons. CWSF is used in 700 industrial furnaces and in hundreds of industrial kilns as a replacement for oil, natural gas and coal briquettes. According to Beijing Zhongjing Zongheng Information and Consulting Center, there are approximately 600,000 traditional fossil fuel burning industrial boilers and kilns currently installed in China, with approximately 100,000 requiring replacement or major repairs each year. According to Frost & Sullivan, overall CWSF demand is expected to grow at a CAGR of 24.7% from 2008 to 2014.

CWSF Market: Total Demand Breakdown (China), 2006 2014E

Source: Frost & Sullivan

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Government Support for CWSF

Government policy mandates for the use of clean coal, and financial subsidies from central, provincial and municipal governments are expected to continue to drive demand for CWSF in the residential heating market, as well as for industrial applications in the metallurgy, ceramics and chemical industries. CWSF is an evolving technology, and future developments are expected to broaden the applications of CWSF, further expanding the size of the market. CWSF has been listed as a key scientific and technological project in each of China's Five-Year Plans since 1981, and in several other major sustainable development policy initiatives. Many provinces and cities across China have adopted specific and quantifiable targets, policies and regulations to promote the usage of CWSF, including financial subsidies to CWSF consumers relating to boiler installations and incentives for attaining threshold levels of CWSF consumption.

Local Chinese Government CWSF Policies and Incentives

Region	Policies and Plans	Incentives
Tongchuan, Shaanxi	Environmental-protection departments are required to strengthen comprehensive CWSF policies to save energy, reduce emissions and promote the application of CWSF and other new clean energies	2008 2012: Government allocated RMB 3.0 million each year as a subsidy for promoting CWSF boilers
		Newly-built CWSF boilers: 10.0% of the total investment
	Convert all coal heating boilers to CWSF boilers or other clean energy sources by 2012	Upgrading coal boilers to CWSF boilers: subsidizing 20.0% of the total investment
	Starting in 2008, all new heating facilities must use CWSF or other clean energy sources	Upgrading oil boilers to CWSF boilers: RMB 100,000 subsidy
		Centralized heat supply using CWSF: RMB 300,000 to RMB 500,000 subsidy depending on scale
	Develop 20 central heating stations using CWSF	

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Region	Policies and Plans	Incentives
Shenyang, Liaoning	Planned to build 56 CWSF boilers from 2000 2003	Favorable loan terms Selected tax exemptions
Nanning, Guangxi	CWSF production of 1.5 million metric tons by 2010 Convert all coal-burning boilers under 35mt/h to CWSF boilers or other clean energies by 2012	2007 2010: Government allocated RMB 3.0 million each year as a subsidy for promoting CWSF boilers Newly-built CWSF boilers: Subsidy of up to RMB 200,000 Centralized heat supply using CWSF: RMB 150,000 to RMB 500,000 subsidy depending on scale
Dongguan, Guangdong	50 boiler users selected to use CWSF	Qualified users: one-time subsidy of 20% of the cost of equipment for upgrade, capped at RMB 1.0 million

Source: Frost & Sullivan

Regional Market Size

We presently have CWSF production operations in the provinces of Shaanxi (at our Tongchuan facility) and Liaoning (at our Shenyang facility) and are planning to expand into the provinces of Guangxi and Guangdong. We believe the regional market size of our current and target markets to be as follows:

Province	Potential Addressable Market Size (metric tons/annum)	Sino Clean Energy's In-place Capacity (metric tons/annum)	# of Suppliers (including Sino Clean Energy)
Shaanxi	5,000,000	550,000	1
Liaoning	6,000,000	300,000	3
Guangxi	9,000,000	0	3
Guangdong	61,000,000	0	7

Source: Beijing Zhongjing Zongheng Information and Consulting Center

Competition

We are the largest third-party CWSF producer in China, as measured by CWSF sales volume for the first half of 2010. The CWSF industry is still at an early stage in China and we have thus far experienced limited competition from domestic CWSF producers. We believe that there are currently no foreign competitors with a material presence in the CWSF industry in China. Currently there are approximately 40 to 50 active CWSF suppliers in China, although most have commercialized sales volumes of less than 100,000 metric tons. Competition is mainly based on establishing a large and stable local customer base in order to gain increased market share. CWSF producers in China compete on a localized level and often lack the capability to expand to a more regional or national scale. Establishing production capacity on a regional basis, typically within 200 kilometers of large customers, is of critical importance in the CWSF industry, as deliveries beyond this radius typically become uneconomical. The table below depicts the top

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five CWSF suppliers in China, as measured by third-party sales volume (i.e. excluding in-house production and consumption).

Rank	Supplier	Primary Geography	Domestic Third Party Sales Volume Q1 to Q2, 2010 (Thousand MT)	Market Share
1	Sino Clean Energy	Xian, Shaanxi	440	15.9%
2	Dongguan Power Fuel	Dongguan, Guangdong	383	13.8%
3	Shandong Bayi	Zoazhuang, Shandong	220	7.9%
4	Datong Huihai	Datong, Shanxi	125	4.5%
5	Gansu Lvtianyuan	Lanzhou, Gansu	110	4.0%
	Others		1,491	53.9%
	Total		**2,769**	**100.0%**

Source: Frost & Sullivan

Our Business Model

Based upon total third party sales revenue in China, we are a leading CWSF producer in China with current annual production capacity of 850,000 metric tons. We are aiming to increase our annual production capacity to approximately 1,850,000 metric tons through the expansion of our existing production facilities in Shenyang and the planned expansion into the provinces of Guangxi and Guangdong. We believe we were among the first companies in China to produce CWSF on a commercial scale, and our first-mover advantage, combined with our reputation for high quality products has allowed us to establish strong customer and supplier relationships. We believe we are well positioned to leverage our increasing scale in order to expand our customer base to meet China's growing demand for CWSF.

We launched our first CWSF plant in the city of Tongchuan, north of Xi'an, the provincial capital of Shaanxi Province in 2007. The Tongchuan plant presently has an annual production capacity of 550,000 metric tons and supplies our customers in Shaanxi Province. In October 2009, we commenced operations at our new CWSF production plant located in Shenyang, the capital of Liaoning Province in northeastern China. The Shenyang plant has an annual output capacity of 300,000 metric tons, increasing our total annual CWSF production capacity to 850,000 metric tons.

Our strong growth has been evidenced by our financial performance. Our revenue increased from $2.8 million in 2007 to $14.3 million in 2008 to $46.0 million in 2009, as a result of our success in expanding our production capacity and increasing our market penetration. During the same period, our income from operations increased from $0.4 million to $4.4 million to $14.2 million, respectively. We intend to grow our business by expanding production capacity at new and existing locations throughout China.

Raw Materials

CWSF is made from coal, water, and chemical additives. Input coal must have a grade of at least 4,500 kc/kg in order to qualify for the production of CWSF. Water does not need to be pre-processed prior to mixing with coal and depending on the source and its content, industrial waste water may be used directly in the production of CWSF. Chemical additives are used in absolving and stabilizing different qualities and sizes of coal with the water. By weight, CWSF is typically comprised of approximately 70% washed coal, 29% water and less than 1% chemical additives.

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Sino Clean Energy Cost of Good Sold Breakdown
for the year ended December 31, 2009

Input	% of COGS
Washed coal	80.29%
Chemical additives	7.06%
Electricity	5.63%
Depreciation	5.47%
Wages	1.05%
Water	0.26%
Employee benefits	0.15%
Miscellaneous	0.09%
Total	**100.00%**

Coal is the primary raw material used to produce CWSF and accounted for approximately 80% of our cost of goods sold during the year ended December 31, 2009. We source coal from nearby coal mines for each of our production facilities. Coal is widely available in China and we maintain long-term relationships with our key suppliers, although alternative suppliers are available if necessary. Our suppliers provide us with washed coal at prevailing market prices, with volumes renegotiated each year. We determine raw material prices based on arm's-length negotiations with our suppliers shortly prior to delivery, with reference to market prices. Our reputation as a dependable counterparty enables us to obtain a stable and low-cost supply of raw material coal for our production facilities. Our long-standing supplier relationships provide us with a competitive advantage in China, and we intend to broaden these relationships to parallel our efforts to increase the scale of our production facilities, thereby maintaining a diverse supplier network while leveraging our purchasing power to obtain favorable pricing and delivery terms. Water and chemical additives are readily available and do not require supply contracts.

For 2008 and 2009, our single largest supplier, Tongchuan Zhaojin Xinyuan Coal Mine, accounted for 85%, and 87% of our total cost of goods sold, respectively. We typically pay for our coal supplies in advance, with a level of deposit that can range up to two months, as this helps to ensure that our coal requirements will be fulfilled.

The price of CWSF varies with the price of coal, and we typically have been able to increase our CWSF prices in response to increased coal prices. Our ability to adjust our selling prices has enabled us to maintain very stable gross margins, typically in the range of 30% to 40%.

Sino Clean Energy Historical Gross Margin

Source: Company reports

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The demand for CWSF for residential heating tends to be seasonal in nature, with peak demand occurring between the months of October through March, as these are the peak heating periods in the markets which we currently serve. Demand for CWSF during peak periods is approximately 30% to 40% higher than during low periods. Demand for CWSF for industrial applications tends to be fairly stable throughout the year, as industrial applications are typically unrelated to heating. The price of CWSF tends to follow the price of coal, which does not necessarily follow seasonal fluctuations.

Processing

We use two methods to produce our CWSF: (i) the High Concentration Preparation with Mixed Grinding ("HCPMG," or grinding process) as illustrated below, and (ii) the Supersonic Fluid Dynamics Atomizer process ("SFDA," or atomizer process). HCPMG is the conventional CWSF production process and is comprised of four major steps: coal pulverization, water mixing, quality control and delivery. The SFDA process differs from the HCPMG process in that it uses a series of ultrasonic chambers to break coal briquettes down into smaller particle form, where it is then mixed with water to create CWSF, while the HCPMG process uses a mechanical pulverization process to mix coal briquettes and water in order to create a finely ground CWSF mixture. The SFDA process requires less electricity and is able to produce finer particle CWSF. The HCPMG production lines can produce coal particles as fine as 50 to 80 microns, while the SFDA production lines can rapidly break coal into particles as fine as 20 to 30 microns. Depending on the capacity and the type of production process, the cost to purchase and install a CWSF production line typically ranges from approximately US$10 to US$30 per metric ton, with higher capacity and more technologically advanced production lines being closer to the high end of this range. In order to reduce production costs, our plants are run primarily at nighttime when electricity costs have been approximately 1/3 of daytime rates.

High Concentration Preparation with Mixed Grinding process

Source: Frost & Sullivan

Inventory

Although coal is not subject to spoilage, we typically limit storage of coal in inventory to a maximum of two months. On average, we maintain a minimum coal reserve of approximately 5,000

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metric tons in Tonghcuan and 3,000 metric tons in Shenyang. Shipments of approximately 3,600 metric tons and approximately 2,000 metric tons are typically delivered every 3 days to the Tongchuan and Shenyang locations, respectively. Production of CWSF is scheduled based substantially on customer orders, which allows us to minimize working capital requirements and to ensure that substantially no inventory is wasted or unusable. CWSF can be stored for up to one year (versus the national standard of one month), but we typically only hold the finished product in inventory for a maximum of two to three days. We currently have capacity to hold up to three days of finished product inventory on-site at each location. Storage and transportation of CWSF is very safe, as the presence of water in CWSF reduces its risk of explosion. As CWSF must be stored above freezing temperature, we use storage tanks that are specially designed to handle fluctuations in external temperatures. To date, we have shipped CWSF inventory using bulk liquid tanker trucks, however, transportation by train has been utilized by other CWSF producers in China. Transportation of CWSF by pipeline is currently under investigation by China's CWSF Research Center. Currently, third-party logistics providers transport approximately 70% of our finished products, with the balance shipped by our own fleet of trucks.

Quality Control

We apply rigorous quality control standards and safety procedures at each of our production facilities. Our manufacturing process is controlled and monitored by a centralized computer control system, which measures and dispenses the precise amount of water and chemical additives required for each production cycle to ensure that each batch of CWSF is consistent with all other batches that we produce. Our quality control technicians regularly test our CWSF production and measure it for condensate, viscosity, evaporation rate, energy content, particle size, sulfur content and ash content.

Although there is no mandatory national standard in China for CWSF quality, the General Administration of Quality Supervision, Inspection and Quarantine of China and the committee of the Standardization Administration of China implemented recommended standards for CWSF in 2002. Our own CWSF production standard exceeds the recommended national standard. We are in the process of obtaining ISO9001:2000 international quality management standard certification for our Tongchuan plant. We plan to obtain a similar certification for our Shenyang facility in the future.

Facilities

We have several production lines at each of our facilities, which are shown in the table below. To minimize technology risk, we have relied primarily on conventional HCPMG technology for CWSF production. In February 2009, we added a production line at our Tongchuan facility that employs SFDA technology, which consumes 10% less electricity than the conventional grinder method, and is able to produce smaller particle CWSF.

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Sino Clean Energy Production Capacity

Production line	Method	Location	Start date	Capacity (metric tons/yr)
In Place				
Line 1	Grinder	Tongchuan	Jul-07	100,000
Line 2	Atomizer	Tongchuan	Feb-09	250,000
Line 3	Grinder	Shenyang	Oct-09	150,000
Line 4	Grinder	Shenyang	Oct-09	150,000
Line 5	Grinder	Tongchuan	Jan-10	200,000
Sub total				**850,000**
Planned development				
Line 6	Grinder	Guangdong	Dec-10	300,000
Line 7	Grinder	Nanning		500,000
Line 8	Grinder	Shenyang		200,000
Sub total				**1,000,000**
Grand total				**1,850,000**

We intend to expand our CWSF production capacity by up to an additional 1,000,000 metric tons by expanding the production capacity at our existing locations and by establishing facilities in new geographic regions. We intend to increase capacity at our Shenyang facility by 200,000 metric tons and we intend to establish CWSF production facilities in the provinces of Guangxi and Guangdong, beginning with 500,000 metric tons in the city of Nanning, Guangxi and 300,000 metric tons in Guangdong.

In August 2010, through our subsidiary, Suoke Clean Energy, we entered into an agreement to purchase a land use right for approximately 5 acres of land and a production factory in Dongguan, Guandong Province. In addition, in September 2010, we entered into an agreement to purchase two production lines to be operated within the new Guangdong facility. The factory is currently undergoing refurbishment and the production lines are being completed and serviced. We anticipate that all of the work will be done by December 2010. We are in the process of taking the necessary steps to obtain a land use right certificate, which is required for us to obtain the rights to use the land and the title to the buildings. The new facility is expected to have an annual production capacity of 300,000 metric tons and is expected to expand our total annual production capacity to 1,150,000 metric tons by the end of 2010.

The additional 1,000,000 metric tons of capacity is expected to require capital expenditures of approximately $34.5 million, which include $16.5 million for land and the construction of production facilities, and $18 million for new production equipments. The land and facilities to be constructed are intended to allow for capacity expansion in the future. In addition, our planned expansion is expected to require additional net working capital of approximately $15 million in order to run the production lines at full capacity. We intend to complete the new production lines, and reach total capacity of 1,850,000 metric tons in the first half of 2011. As of September 30, 2010, we have made initial deposits of $555,000 for the new Guangdong facility and in the amount of $1,612,000 for the purchase of two production lines.

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We occupy both owned and leased properties for our operations. We own the land use right to a total of 43,956 square meters of land for our existing site in Tongchuan for a period of 50 years, expiring on December 8, 2057. The buildings and facilities at our Tongchuan location constructed by us are used for the purposes of production, research and development and employee housing. At our Shenyang facility, we have entered into a 10-year lease agreement for the land use right to a total of 7,400 square meters of land, which expires on August 1, 2019. Our principal executive and administrative offices are located in Xi'an, China in approximately 233 square meters of purchased office space.

Customers

Currently all of our customers are based in China and use our CWSF for either industrial purposes or for heating in residential and commercial buildings. As industrial users use the steam generated by CWSF boilers for power and heat in manufacturing processes, there is little seasonality in their consumption of CWSF. Currently, our industrial customers encompass a diverse range of industries such as wineries, paperboard manufacturing, food processing, and ceramic manufacturing. Residential and commercial heating customers experience peak heating demand for approximately 150 days between October and March, and their consumption of CWSF fluctuates accordingly. The following table sets forth the percentage of our revenues by our two principal groups of CWSF customers for the periods indicated:

Sino Clean Energy Customer Breakdown (2007 2009)

As of September 30, 2010, we had 43 customers, 38 of which were located within Shaanxi Province (which are being serviced by the Tongchuan facility), and five of which were located in Liaoning Province (which are being serviced by the Shenyang facility). In order minimize logistics costs, we typically sell our CWSF to customers within a 200 kilometer radius of our production facilities. We sell and distribute CWSF directly to our customers. In 2009, our ten largest customers

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represented 62.0% of total volume sold, while the single largest customer represented 11.5% of total volume sold. During 2009, our ten largest customers by tonnage sold were as follows:

2009 Top Ten Customers

Customer	**Type**	**Sales Volume (metric tons)**	**%**
Shenyang Haizhong Heating	Residential Heating	52,242	11.5%
Shaanxi Dade Property	Residential Heating	28,649	6.3%
Shaanxi Tongchuan Yitong	Industrial Products	27,947	6.1%
Shaanxi Urban Development	Integrated Industrial	26,531	5.8%
Lihua Winery	Industrial Products	25,573	5.6%
Xi'an Institute of Architecture	Integrated Industrial	25,505	5.6%
Shaanxi Baidu Industries	Industrial Products	24,916	5.5%
Shaanxi Huayuan Paper	Industrial Products	24,587	5.4%
Qinling Cement Property	Residential Heating	23,680	5.2%
Tongchuan Minerals Board	Integrated Industrial	23,085	5.1%
Subtotal		**282,715**	**62.0%**
Other		173,482	38.0%
Total		**456,197**	**100.0%**

We are the dominant CWSF producer in both of our present markets: Shannxi province and Liaoning province. We believe that we are able to differentiate ourselves from our competitors by building a track record and reputation for high quality products and service, by securing long-term customer contracts in each of the target markets, and by selectively expanding into new regional markets. We believe that our CWSF products' high quality gives us a competitive advantage in attracting new customers and retaining existing customers. The emerging growth of the CWSF industry in China, and the market opportunity require that CWSF suppliers have certain skills to work across the value chain. We believe that our management's vision and expertise enables us to forge the necessary partnerships with CWSF industry participants, including boiler vendors, local governments, coal suppliers, and CWSF consumers, allowing us to replicate our model in other geographic regions in order to expand more rapidly than our competitors.

Customer & Supply Contracts

Sales

Our sales contracts outline total sales volume, price, product specifications, delivery schedule, and method of delivery. We have entered into three to five year framework agreements with the majority of our customers whereby we provide CWSF at prevailing market prices, and volumes are renegotiated each year. We have framework agreements in place with approximately 90% of our customers. Typically, the CWSF consumption volume of any given boiler does not fluctuate significantly from year to year. Once established, the customer base for CWSF is very stable, as the consumption patterns are highly predictable and the costs to switch CWSF boilers to other fuels are prohibitively expensive. Current CWSF prices for sales contracts with customers in Tongchuan range from RMB 770 to RMB 810 per metric ton and CWSF prices for sales contracts with customers in Shenyang are RMB 960 per metric ton. CWSF transportation costs and the associated risks are covered by us at both the Tongchuan facility and the Shenyang facility. The prices paid by customers at the Shenyang facility are higher mostly because the coal materials cost is higher in Shenyang, as our customers are relatively farther away from the production facility. If the market price of CWSF differs by more than 10% of the original price quoted in the contract, either above or below, the sales price is re-negotiated. Pursuant to the annual sales agreements, customers generally pay for CWSF on

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a monthly basis, with payment collected in cash upon delivery. We occasionally provide our customers with extended credit terms of up to three months, for example to certain government residential heating agencies. We set payment methods depending on our business relationship, customers' credit records and prevailing market conditions.

Coal supply

We have entered into coal supply contracts with coal mines/coal washing facilities that are near our CWSF production facilities. We have agreements with three such suppliers in Tongchuan and another two in Shenyang. The supply contracts define supply volume, pricing, term, product specifications, and delivery schedule. We set the maximum amount of supply volume, which is guaranteed by the coal supplier. In Tongchuan, we have historically drawn most of our coal supplies from a single supplier and a small portion from another supplier. We are provided coal at prevailing market prices, and volumes are renegotiated each year. However, if the market price of coal exceeds the price initially quoted in the supply contract by 20%, then a new contract can be negotiated. Suppliers must deliver the coal to us within two months after we notify the supplier of our need for coal.

Qingdao Haizhong Enterprise Co., Ltd. ("Haizhong Boiler")

Through our subsidiary, Suo'ang New Energy, we act as the exclusive sales agent for Haizhong Boiler, which is an unrelated third-party manufacturer of CWSF boilers in China. Haizhong Boiler started producing boilers in 1999, and is one of the largest boiler manufacturers in China, with an estimated 78% market share in the Chinese CWSF boiler market (according to Beijing Zhongjing Zhongheng Information and Consulting Center, Haizhong Boiler's market share was determined on December 30, 2009 and was valid until October 31, 2010). We entered into a sales agency agreement with Haizhong Boiler in February 2008 whereby we act as the exclusive distributor for Haizhong Boiler's CWSF boilers in Xi'an and Tongchuan in Shaanxi Province. Following the success of the sales agency agreement in Shaanxi Province we entered into a nationwide strategic partnership agreement with Haizhong Boiler in July 2009, pursuant to which Haizhong Boiler focuses on selling CWSF boilers, and in some markets operating heat supply plants, while we are the exclusive supplier of the requisite CWSF. To date, we have sold 51 boilers for Haizhong Boiler, all of which were sold to users that ultimately purchased CWSF from us.

Shenyang Haizhong Heat Resource Co., Ltd. ("Haizhong Heat")

We have entered into an agreement with Haizhong Heat, which is an unrelated third-party municipal heat supplier in Shenyang. Haizhong Heat was founded in 2007 when it was partially spun-out of Haizhong Boiler, which retains a majority equity interest in Haizhong Heat. Haizhong Heat has signed an exclusive agreement with the Shenyang municipal government to provide heat to local businesses, residential buildings and hospitals within an area of 1,200 hectares. We are the exclusive CWSF supplier to Haizhong Heat. The current area serviced by Haizhong Heat is 4 million square meters, which requires approximately 300,000 metric tons of CWSF on an annual basis. Haizhong Heat has stated its intention that the service area will be increased to 10 million square meters, requiring approximately 850,000 metric tons of CWSF annually by the end of 2012.

Nanning facility

In November 2009, through our subsidiary, Suoke Clean Energy, we entered into a memorandum of understanding with the local government of Nanning, Guangxi Province, pursuant to which we plan to establish a 500,000 metric ton per annum CWSF production facility in the city of Nanning. We expect to commence construction on the facility in early 2011, with a view to commencing commercial

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production in the first half of 2011. The Nanning government is aggressively promoting the usage of CWSF as an alternative fuel, and has publicly indicated its intention to establish local CWSF production capacity of 3 million metric tons. Presently, there are only two local CWSF producers in Nanning, each with a capacity of approximately 100,000 metric tons. We have entered into an agreement with Guangxi New Heat Energy Company ("GNHEC") pursuant to which we act as the exclusive CWSF provider in the Jin Kai Industrial Park of Nanning Economic and Technological Development Area. We and GNHEC are in discussions with over 20 potential customers.

Guangdong facility

In August 2010, through our subsidiary, Suoke Clean Energy, we entered into an agreement to purchase a land use right for approximately 5 acres of land and a production factory in Dongguan, Guandong Province for a total purchase price of $5,550,000. In addition, in September 2010, we entered into an agreement to purchase two production lines to be operated within the new Guangdong facility for a total purchase price of $5,372,000. The factory is currently undergoing refurbishment and the production lines are being completed and serviced. We anticipate that all of the work will be done by December 2010. We are in the process of taking the necessary steps to obtain a land use right certificate, which is required for us to obtain the rights to use the land and the title to the buildings. The new facility is expected to have an annual production capacity of 300,000 metric tons and is expected to expand our total annual production capacity to 1,150,000 metric tons by the end of 2010. We are targeting large CWSF customers in Guangdong, as the province is one of the most economically developed in China, and has the largest consumer capacity for CWSF in China, according to Beijing Zhongjing Zongheng Information and Consulting Center.

Tongchuan government

We have entered into an agreement with Tongchuan City Investment and Development Co., Ltd. ("TCID") to develop and provide CWSF to a new heat supply company for the purpose of providing heating for the new district in Tongchuan. TCID expects that 15 new heat supply plants will need to be built to supply an area of approximately 16.4 million square meters. The first three plants are expected to be built and operational by the end of 2010, with the remaining plants expected to be completed over the following five to seven years. The newly formed heat supply company will require an investment of $12.5 million by TCID, for which it will receive an 85% stake in the new company, and $2.2 million by Suo'ang New Energy, for which it will receive a 15% stake in the new company.

Sales, Marketing and Customer Development

As the CWSF industry develops, we constantly seek out opportunities to participate in energy-related tradeshows and government-sponsored events to promote CWSF as an alternative clean energy with our Company as a preferred supplier. A CWSF promotion center has been established at our Tongchuan plant, jointly with the local government, for the purpose of demonstrating and promoting CWSF and to enhance public knowledge and awareness of CWSF.

We conduct our sales efforts through direct sales by our own in-house sales personnel located in Xi'an and Shenyang. We sell our CWSF mainly to customers located within a radius of 200 kilometers of our production facilities. Our sales team places a strong emphasis on building long-term relationships with our customers by proactively seeking customer feedback. Our sales personnel regularly visit customers to obtain feedback on our performance and gather market information.

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Research and Development

Our CWSF manufacturing technology was developed in-house by our research and development department. Our research and development team comprises 10 professionals, 7 of whom are internal and 3 of whom are external experts and consultants. Furthermore, we have entered into agreements with two local universities pursuant to which we will invest RMB 5 million in research projects over a term of 30 months and 36 months, respectively. The agreements, as amended, specify that we will have all intellectual property rights to the outcome of the research and development. We believe that our emphasis on research and development, innovation, and continuous product and process improvements will enable us to maintain and expand our leading position in the CWSF industry in China.

The primary focus of our research and development initiatives has been to decrease our CWSF's particle size, which can result in higher efficiency fuel with a broader range of applications. Furthermore, our research and development efforts have generated technological improvements that have been instrumental in lowering our production costs and increasing operational efficiency. We are currently developing new specialties of CWSF products and we have also conducted research on and implemented new CWSF production methods by adopting new chemical additives.

Personnel and Staff

Our senior management team and key operating personnel have the management skills, relevant operating experience and industry knowledge that we believe are required to succeed in the CWSF industry. We believe our management team's in-depth knowledge and deep industry relationships within the CWSF market in China will enable us to execute our expansion strategy and to take advantage of market opportunities.

We had 147 employees as of September 30, 2010. From time to time, we employ third-party research and development consultants. We have never experienced any significant labor disputes and consider our relationship with our employees to be good. We expect that our staffing needs will expand as we continue to expand our production capacity. The following table shows a breakdown of our employees by function and geography as of September 30, 2010:

	Tongchuan facility	Shenyang facility	Xi'an head office	Total
Management	3	2	7	12
Sales and marketing	13	6		19
Technical staff	7	4		11
General and administrative	7	6	11	24
Manufacturing	53	28		81
Total	**83**	**46**	**18**	**147**

Insurance

We provide social security insurance including pension insurance, unemployment insurance, work related injury insurance and medical insurance for our employees. Although we currently maintain fire, casualty and property insurance covering our two production lines in Shenyang and three production lines in Tongchuan, we do not maintain any business interruption insurance or any third party liability insurance to cover claims related to personal injury, property or environmental damage arising from accidents on our properties.

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Intellectual Property

Currently, the only trademark we use for our business is , which is registered in the PRC under Suo'ang BST. We have filed the requisite documentation for the transfer and assignment of the trademark with the appropriate governmental authority and are waiting to receive approval.

Environmental Matters

The Environmental Protection Law of the PRC governs us and our CWSF products. The Environmental Protection Law, promulgated by the National People's Congress on December 26, 1989, is the primary law for environmental protection in China. The law establishes basic principles for coordinated advancement of economic growth, social progress and environmental protection, and defines the rights and duties of governments at all levels. Local environmental protection bureaus may set stricter local standards than the national standards and enterprises are required to comply with the stricter of the two sets of standards. The Environmental Protection Law requires any entity operating a facility that produces pollutants or other hazards to incorporate environmental protection measures into its operations and to establish an environmental protection responsibility system, which must adopt effective measures to control and properly dispose of waste gases, waste water, waste residue, dust or other waste materials. We endeavor to ensure the safe and lawful operation of our facilities in manufacturing and distribution of CWSF and, except as set forth under "Risk Factors We may be subject to warnings, payment of damages and fines if we violate the Environmental Protection Law," believe we are in compliance in all material respects with applicable PRC laws and regulations. All of our products meet the relevant environmental requirements under PRC laws and we have not been subject to any material fines or legal action involving non-compliance with any relevant environmental regulation, nor are we aware of any threatened or pending action, including by any environmental regulatory authority.

Properties

In July 2006, we purchased a land use right for the property located in Tongchuan City's Yaozhou District where our CWSF plant is situated, and obtained the land use right certificate for this property in December 2007. The land use right allows us to lease this property for a period of fifty (50) years. In June 2007, the first phase of the plant became operational and CWSF production commenced in July 2007. In August 2009, we entered into a 10-year lease agreement for the land use right to a total of 7,400 square meters of land for the property located in Shenyang City's Dongling District, where our CWSF plant is situated.

In August 2010, through our subsidiary, Suoke Clean Energy, we entered into an agreement to purchase a land use right for approximately 5 acres of land and a production factory in Dongguan, Guandong Province. In addition, in September 2010, we entered into an agreement to purchase two production lines to be operated within the new Guangdong facility. The factory is currently undergoing refurbishment and the production lines are being completed and serviced. We anticipate that all of the work will be done by December 2010. We are in the process of taking the necessary steps to obtain a land use certificate, which is required for us to obtain the rights to use the land.

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The table below provides summary descriptions of the properties used for the Company's business operations as at November 15, 2010:

Property Location	Area (sq m)	Expiration Date	Purpose
Room 1502, Building D, Wangzou International City Building No. 3 Tangyuan Road Gaoxin District, Xi'an, Shaanxi Province, PRC	233	July 19, 2052	Company headquarters
Wangjiabian Village, Dongjiahe Town, Yaozhou District, Tongchuan Shaanxi Province, PRC	43,956	December 8, 2057	CWSF production plant and raw materials warehouse
Wenguantun, Qianjin Town, Dongling District, Shenyang, Liaoning Province, PRC	7,400	August 1, 2019	CWSF production plant and raw materials warehouse

Legal Proceedings

We may be subject to, from time to time, various legal proceedings relating to claims arising out of our operations in the ordinary course of our business.

MANAGEMENT

Our current executive officers and directors as of the date of this prospectus are as follows:

Directors and Executive Officers	Position/Title	Age
Baowen Ren	Chief Executive Officer and Chairman of the Board	40
Wen (Wendy) Fu	Chief Financial Officer	41
Hon Wan Chan	Vice President of Finance	48
Xueping Wang	Chief Technological Officer and Vice President of Sales	47
Peng Zhou	Director	41
Wenjie Zhang(1)(2)(3)	Independent Director	37
Albert Ching-Hwa Pu(1)(2)(3)	Independent Director	51
Zidong Cao(1)	Independent Director	59

(1) Serves as a member of the Audit Committee.

(2) Serves as a member of the Compensation Committee.

(3) Serves as a member of the Nominating and Corporate Governance Committee.

The following is a summary of the biographical information of our executive officers and directors. Any gap in employment background of an individual indicates that the individual did not obtain work experience relevant to his or her role as an officer or director during such period.

Baowen Ren has served as our Chief Executive Officer and Chairman of the Board since October 2006. From January 2003 to December 2009, Mr. Ren served as the Chairman of the Board and Chief Executive Officer of Suo'ang BST. Mr. Baowen Ren, is a prominent figure in China's CWSF industry with over seven years' experience in CWSF research, development and sales. As a member of the China CWSF Research Center, the China Association of Environmental Protection Industry, and the China Association of Low-Carbon Economy, Mr. Ren is very familiar with China's clean energy policies, regulations, and directions, and the role that CWSF plays within China's clean coal technology plan. Since 2005, Mr. Ren has built the largest CWSF production base in northwest China. In 2008, Mr. Ren issued the paper "The Development of CWSF under the Movement of National Energy Conservation and Emission Reduction", which was adopted by the National CWSF Promotion Work Conference Paper Collection. Mr. Ren has received numerous accolades and acknowledgements for his achievements and success, including a designation as "Shaanxi Top 100 Entrepreneur". In 1992, Mr. Ren graduated from Shaanxi Normal University and received a B.A. degree Chinese Language and Literature.

Wen (Wendy) Fu has served as our Chief Financial Officer since February 2010. Prior to joining us, Ms. Fu served as the Chief Financial Officer of China Shenghuo Pharmaceutical Holdings Inc., a NYSE-AMEX listed company from September 2008 to August 2009. From August 2007 to March 2008, Ms. Fu served as VP-Finance of Shengdatech, Inc., a China based NASDAQ listed company and chemical manufacturer in China. From December 2005 to June 2007, Ms. Fu worked for Deloitte & Touche, LLP (USA), a globally recognized accounting firm, as a Senior Consultant. From May 1999 to May 2004, Ms. Fu served as Assistant Finance Controller at Wal-Mart China, a subsidiary of Wal-Mart Inc., a Fortune 500 company, listed on the NYSE. From 1997 to 1999, Ms. Fu was the Regional Finance Manager at Asia Pulp & Paper (APP) Co., Ltd., the second largest paper

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company in Asia, listed on the NYSE. In 1989, Ms. Fu graduated from the International Trade program at Wuhan Jianghan University, and in 2005 from the University of Austin, Texas and received a Masters degree in Professional Accounting. Ms. Fu has been a CPA since 2007.

Hon Wan Chan has served as our Vice President of Finance since February 2010. Prior to that, he served as our Chief Financial Officer from December 2008 to February 2010. Mr. Chan was a principal of CC Alliance CPA & Co from March 2008 to December 2008. He served as the Business Director for Texwood Group, from November 2006 to February 2008, overseeing the company's business administration, finance and accounting, and as an in-house accountant from April 2000 to June 2005. Mr. Chan was the Chief Financial Officer of South China Media Group from July 2005 to October 2006. In 1985, Mr. Chan graduated from Macquarie University in Australia and received a B.A. degree in Accounting, and he graduated from Hong Kong Polytechnic University and received a Masters degree in Accounting. He is an associate member of both The Institute of Chartered Accountants in Australia and The Hong Kong Institute of Certified Public Accountants.

Xueping Wang has served as our Chief Technology Officer and Vice President of Sales since October 2006. Ms. Wang has experience with large Chinese state owned enterprises and private companies, and from 1987 to 1999 she was the Vice President, Deputy General Manager and Chief Engineer of Xi'an Plastic Production Company. Ms. Wang began research in CWSF in December 2004, as part of the research and development team for Suo'ang BST, focusing on papermaking, black liquor, CWSF, sewage sludge and high efficiency desulfurization CWSF dispersants. In 1987, Ms. Wang graduated from Northwest University and received a B.S. degree in Organic Chemical Engineering, with a focus on technology research and applications management of polymer chemicals and coal chemicals.

Peng Zhou has served as a director on our Board since October 2006 and as Chief Operating Officer of Shenyang Energy since October 2009. He served as the General Manager of Suo'ang BST from January 2005 to December 15, 2009. From April 2000 to December 2004, Mr. Zhou served as the General Manger of Shaanxi Pengyuan Technology Co., Ltd. He was a credit analyst for the Hangzhong branch of the Industrial and Commercial Bank of China from September 1992 to February 1999. In 1992, Mr. Zhou graduated from Xi'an Jiao Tong University and received a B.A. degree in Statistics.

Wenjie Zhang has served as a director on our Board since October 2006. Since 2005, he has served as the General Manager of Hanzhong Huaxia Real Estate Co., Ltd. From January 2002 to 2005 Mr. Zhang was the Manager of Engineering Department of Hanzhong International Trade Co., Ltd. from January 2002 to December 2005. In 1995 Mr. Zhang graduated from the Xi'an Science Institution and received a B.A. degree in Administration, and in 1997 graduated from Shaanxi Hanzhong Business College and received a college diploma in Business and Trade.

Albert Ching-Hwa Pu has served as a director on our Board since November 2009. Mr. Pu has served as the Chief Financial Officer of China Integrated Energy Inc., (NASDAQ: CBEH), a U.S. publicly traded alternative energy company since February 2009. From February 2005 to January 2009, Mr. Pu was the Global Controller of Amphenol Corporation Industrial Operations, a division of Amphenol Corporation (NYSE: APH), a U.S. based multi-national manufacturing company specializing in interconnection systems, where he managed and directed finance teams in China and North America with respect to financial activities and policy implementations. In 1990, Mr. Pu graduated from the State University of New York, Institute of Technology and received a B.S. degree in Accounting. He is a New York State Certified Public Accountant.

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Zidong Cao has served as a director on our Board since December 2008. Dr. Cao is a scientist with substantial knowledge of the coal and related industries in China. He is presently the Assistant Dean of the School of Energy & Power Engineering and Associate Director of the Research Center on Environmental Science & Engineering at Xi'an Jiao Tong University (the "University"). Dr. Cao was previously the Director of the University's Boiler Laboratory and the Boiler Teaching & Research Office. He is a member of the National Committee of Boiler Standardization and is the Vice Chairman of the Xi'an Association of Thermal Energy & Dynamics. In 1985, Dr. Cao graduated from the University's School of Energy and Power Engineering and received a Ph.D. in Energy and Power Engineering, focusing on boiler research.

Significant Employees

Name	Position/Title	Age
Peng Zhou	Chief Operating Officer	41
Fu Li	General Manager	45

Peng Zhou has served as the Chief Operating Officer of our PRC subsidiary, Shenyang Energy, since October 2009. Mr. Zhou is responsible for establishing Shenyang facilities and is in charge of its day to day operation.

Fu Li has served as the General Manager of Shenyang Energy since October 2006. In 1984, Mr. Li graduated from Shaanxi Radio and TV University with a B.S. degree in Mechanical Engineering. Mr. Li has experience with a large scale cement company, and from 1984 to 1997 was in charge of production management for Tongchuan Dongfeng Cement as a Director and Deputy Production Director.

All of our directors will hold their positions on the board until our next annual meeting of the stockholders and until their respective successors have been elected or appointed. Executive Officers serve at the discretion of the board of directors.

Family Relationships

There are no family relationships between or among any of our current directors, executive officers or significant employees.

Director Independence

Our common stock is listed on the NASDAQ Global Market. We use the definition for independence set forth in Rule 5605(a)(2) of the NASDAQ Marketplace Rules to determine that we have a majority of the Board comprised of "independent" directors, and to determine that the committees of our Board are comprised of "independent" directors. Based on those standards, the Board has determined that Albert Ching-Hwa Pu, Wenjie Zhang and Zidong Cao are independent directors, who make up a majority of the directors on our Board.

Committees of the Board of Directors

Audit Committee

Our audit committee consists of Albert Ching-Hwa Pu, Wenjie Zhang and Zidong Cao, each of whom is independent. The audit committee assists with Board oversight of (i) the integrity of our financial statements, (ii) our compliance with legal and regulatory requirements, (iii) the independent auditor's qualifications and independence, and (iv) the performance of our internal audit function and independent auditor, and prepares the report that the SEC requires to be included in our annual proxy statement. The audit committee operates under a written charter. Mr. Pu is the Chairman of the audit committee.

The Board of Directors determined that Mr. Pu possesses accounting or related financial management experience that qualifies him as financially sophisticated within the meaning of Rule 4350(d)(2)(A) of the NASDAQ Marketplace Rules and that he is an "audit committee financial expert" as defined by the rules and regulations of the SEC.

Nominating and Corporate Governance Committee

The purpose of the nominating and corporate governance committee is to assist the Board of Directors in identifying qualified individuals to become members of our Board of Directors, in determining the composition of the Board of Directors and in monitoring the process to assess Board effectiveness. Each of Albert Ching-Hwa Pu and Wenjie Zhang are independent members of the nominating and corporate governance committee. The nominating and corporate governance committee operates under a written charter. Mr. Zhang is the Chairman of the nominating and corporate governance committee.

Compensation Committee

The compensation committee is responsible for overseeing and, as appropriate, making recommendations to the Board regarding the annual salaries and other compensation of the Company's executive officers and general employees and other policies, and for providing assistance and recommendations with respect to the compensation policies and practices of the Company. Each of Albert Ching-Hwa Pu and Wenjie Zhang are independent members of the compensation committee. The compensation committee operates under a written charter. Mr. Zhang is the Chairman of the compensation committee.

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EXECUTIVE COMPENSATION

The following summary compensation table indicates the cash and non-cash compensation earned for years ended December 31, 2009 and 2008 by our chief executive officer and each of our other three highest paid executives whose total compensation exceeded $100,000 (if any) for the years ended December 31, 2009 and 2008.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)(1)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Baowen Ren, CEO	2009	17,518							17,518
	2008	15,282							15,282

(1) Compensation for the years shown was paid in RMB which, for reporting purposes, has been converted to U.S. dollars at the conversion rate of RMB 6.85 to one U.S. dollar for 2009 and RMB 7.0671 to one U.S. dollar for 2008.

Employment Agreements, Termination of Employment and Change-in-Control Arrangements with our Executive Officers

Except as described below, we currently have no employment agreements with any of our executive officers, nor any compensatory plans or arrangements resulting from the resignation, retirement or any other termination of any of our executive officers, from a change-in-control, or from a change in any executive officer's responsibilities following a change-in-control.

Employment Agreement with Baowen Ren

On June 10, 2010, we entered into an employment agreement with Mr. Baowen Ren to serve as our Chief Executive Officer for a term of one year with an annualized compensation of RMB120,000 ($17,647). Mr. Ren is entitled to reimbursement of reasonable business expenses incurred in connection with his employment. We may terminate the employment agreement for cause or if Mr. Ren becomes disabled or dies. The employment agreement may also be terminated by us or Mr. Ren upon 30-day written notice. The employment agreement contains certain restrictive covenants applicable during his employment and thereafter preventing both competition with us and disclosure of our confidential information.

Employment Agreement with Hon Wan Chan

On December 15, 2008, we entered into an employment agreement with Mr. Chan to serve as our chief financial officer for a term of one year with an annualized compensation of RMB 180,000 ($26,470). Mr. Chan is entitled to reimbursement of reasonable business expenses incurred in connection with his employment. We may terminate the employment agreement for cause or if Mr. Chan becomes disabled or dies. The employment agreement may also be terminated by us or Mr. Chan upon 30-day written notice. The employment agreement contains certain restrictive covenants applicable during his employment and thereafter preventing both competition with us and disclosure of our confidential information.

Concurrent with the execution of the employment agreement, we also entered into a non-qualified stock option agreement with Mr. Chan in which we granted Mr. Chan an option to purchase up to 10,000 shares of the Company's common stock at an exercise price of $2.40 per share exercisable until December 15, 2010, unless Mr. Chan's employment was terminated. Mr. Chan's option was exercised in full on March 16, 2010. Mr. Chan resigned from his position as our chief

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financial officer, effective February 12, 2010. Mr. Chan remains with us and is serving as the vice president of finance.

Employment Agreement with Wen (Wendy) Fu

On February 12, 2010, we entered into an employment agreement with Ms. Fu to serve as our chief financial officer for a term of one year with a monthly salary of $5,000. Ms. Fu is also entitled to reimbursement of reasonable business expenses incurred in connection with her employment. We may terminate the employment agreement for cause or if Ms. Fu becomes disabled or dies. The employment agreement may also be terminated by us or Ms. Fu upon a 30-day written notice. The employment agreement contains certain restrictive covenants applicable during her employment and thereafter preventing both competition with us and disclosure of our confidential information.

Pursuant to the terms of the employment agreement, we agreed to grant to Ms. Fu an option to purchase up to 10,000 shares of the Company's common stock at an exercise price that would be equal to the last reported sale price on the OTCBB on the grant date, exercisable for a period of two years from the grant date, unless Ms. Fu's employment is terminated. If the termination arises from Ms. Fu's disability or death, the option is exercisable for up to a period of 12 months following the disability or death, and if we terminate Ms. Fu's employment for cause, the option is terminated immediately. For any other termination, the option is exercisable for up to three months following such termination. On February 23, 2010, we entered into a non-qualified stock option agreement with Ms. Fu, which granted the options at an exercise price of $4.35 exercisable until February 23, 2012.

Outstanding Equity Awards at Fiscal Year-End

The following table reflects the outstanding equity awards of the above-named executive officers outstanding as of December 31, 2009.

Outstanding Equity Awards at Fiscal Year Ended December 31, 2009

Option Awards

Name	Number of Securities Underlying Unexercised Options Exercisable	Number of Securities Underlying Unexercised Options Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options	Option Exercise Price ($)	Option Expiration Date
Hon Wan Chan	10,000(1)	0	0	$ 2.40	12/15/2010

(1) These options were exercised in full on March 16, 2010.

Compensation of Directors

The following director compensation disclosure reflects all compensation awarded to, earned by or paid to the directors below for the year ended December 31, 2009.

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DIRECTOR COMPENSATION TABLE

Name	Year	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Peng Zhou[(1)]	2009							
Wenjie Zhang[(1)]	2009							
Bennet Tchaikovsky[(2)]	2009	35,750						35,750
Zidong Cao[(3)]	2009							
Albert China-Hwa Pu[(4)]	2009	3,250						3,250
Yong Li[(5)]	2009	13,000						13,000

(1) These persons became our directors in connection with the share exchange transaction that closed on October 20, 2006. We do not have any compensation arrangements with these directors.

(2) Mr. Tchaikovsky was appointed to our board of directors effective December 15, 2008, and was entitled to receive annual compensation of $39,000 for his services rendered as a director, as well as chairman of the audit committee and member of the compensation and nominating and corporate governance committees. Mr. Tchaikovsky resigned from his position as a director on November 24, 2009.

(3) Dr. Cao was appointed to our board of directors effective December 15, 2008, and is entitled to receive annual compensation of $10,000 for his services rendered as a director, as well as member of the audit, compensation and nominating and corporate governance committees.

(4) Mr. Pu was appointed to our board of directors on November 24, 2009, and is entitled to receive annual compensation of $39,000 for his services as a director, as well as a member of the audit, compensation and nominating and corporate governance committees.

(5) Mr. Li resigned from our board of directors on November 16, 2010.

Director Agreements

In connection with the appointments of Dr. Cao and Mr. Pu to our board of directors, we entered into agreements with each of them as follows:

Pursuant to our agreement with Dr. Cao, in addition to his duties as a director, he will serve on the audit committee, compensation committee and the nominating and corporate governance committee as a member, for annual cash compensation of $10,000. We also agreed to include Dr. Cao as an insured under our directors and officers insurance policy.

Pursuant to our agreement with Mr. Pu, in addition to his duties as a director, he will serve as the chairman of the audit committee and member of the compensation committee and nominating and corporate governance committee for annual cash compensation of $39,000 payable quarterly in equal installments. We also agreed to include Mr. Pu as an insured under our directors and officers insurance, and will reimburse Mr. Pu for reasonable expenses incurred in connection with the performance of duties as a director of the Company, including travel expenses.

Indemnification of Officers and Directors

We are a Nevada corporation, and accordingly, we are subject to the corporate laws under the Nevada Revised Statutes. Pursuant to Article 7 of our articles of incorporation and Nevada's Revised Statutes, our bylaws contain the following indemnification provision for our directors and officers:

"The corporation shall indemnify directors, officers, employees, and agents of the corporation to the extent required by the Nevada Revised Statutes and shall indemnify such individuals to the extent permitted by the Nevada Revised Statutes. The corporation may purchase and maintain liability

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insurance, or make other arrangements for such obligations or otherwise, to the extent permitted by the Nevada Revised Statutes."

Such indemnification provision may be sufficiently broad to permit indemnification of our executive officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act. We currently carry directors' and officers' liability insurance covering our directors and officers for a period of one year commencing September 4, 2010. The limit of liability of such insurance is $5,000,000 in the aggregate for the insured period. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. No pending material litigation or proceeding involving our directors, executive officers, employees or other agents as to which indemnification is being sought exists, and we are not aware of any pending or threatened material litigation that may result in claims for indemnification by any of our directors or executive officers.

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CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Since January 1, 2007, we have engaged in the following transactions with our directors, executive officers, holders of more than five percent of our voting securities, and affiliates of our directors, executive officers and five-percent stockholders.

Acquisition of Minority Interest

On June 30, 2008, we entered into a Securities Purchase Agreement with Mr. Peng Zhou, who is one of our directors and at that time was our Chief Operating Officer of Suo'ang BST, to acquire his 20% equity ownership interest in Suo'ang New Energy. Pursuant to the terms of our agreement with Mr. Zhou was to receive 750,000 shares of our common stock as consideration for the sale of the interest. Additionally, Mr. Zhou agreed to waive any and all rights he may have to any distributions and/or payments from Suo'ang New Energy beginning January 1, 2008. Suo'ang New Energy was 80% owned by Suo'ang BST, which was controlled by Hangson, through a series of contractual arrangements. 20% of Suo'ang New Energy was owned by Mr. Peng Zhou. Hangson was entitled to acquire the remaining 20% of Suo'ang New Energy from Mr. Zhou. However, the transfer was not completed, and although Mr. Zhou remained as the record shareholder of Suo'ang New Energy, he still received 750,000 shares of common stock as consideration for the agreement. On November 10, 2009, Suo'ang BST and Hangson entered into a subsequent share transfer agreement with Suoke Clean Energy to transfer 80% of Suo'ang New Energy's equity interests to Suoke Clean Energy and, Mr. Zhou, with Hangson's consent, entered into a share transfer agreement with Suoke Clean Energy to transfer the remaining 20% equity interest of Suo'ang New Energy.

Other than the above transactions, neither we, our subsidiaries or our former VIEs have entered into any material transactions with any director, executive officer, and nominee for director, beneficial owner of five percent or more of our common stock, or family members of such persons since January 1, 2007.

Loans by Related Parties

In 2008, Mr. Zhou and Mr. Ren loaned $395,049 and $70,000, respectively, to Suo'ang BST to facilitate its operations. Mr. Ren made additional loans in the amount of $3,466 in 2009. The loans were interest-free, unsecured and are due on demand. As of December 31, 2009, Mr. Zhou's loan had been repaid in full. As of September 30, 2010 amounts due to Mr. Ren were $73,456.

Procedures for Approval of Related Party Transactions

Our board of directors is charged with reviewing and approving all potential related party transactions. All such related party transactions must then be reported under applicable SEC rules. We have not adopted other procedures for review, or standards for approval, of such transactions, but instead review them on a case-by-case basis.

Promoters and Certain Control Persons

On October 18, 2006, we entered into and consummated the share exchange under the Exchange Agreement. As a result of the share exchange, Hangson became our wholly owned subsidiary, and the shareholder of Hangson acquired 2,600,000 shares of our common stock, representing approximately 92% of our issued and outstanding common stock. Prior to the closing of the Exchange Agreement, on September 30, 2006, Peter Day, the Company's former CEO, President, CFO and sole director, purchased all of our assets and shares in Endo Networks, Inc., a corporation incorporated under the laws of Canada from us pursuant to an Asset and Share Purchase Agreement dated as of June 26, 2006. As consideration for all of the assets, and all of the shares of Endo Networks Inc., Mr. Day assumed all of our liabilities prior to the Share Exchange, except for certain excluded liabilities.

BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table sets forth certain information regarding our common stock beneficially owned as of the date hereof, for (i) each stockholder known to be the beneficial owner of 5% or more of our outstanding common stock, (ii) each executive officer and director, and (iii) all executive officers and directors as a group. In general, a person is deemed to be a "beneficial owner" of a security if that person has or shares the power to vote or direct the voting of such security, or the power to dispose or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which the person has the right to acquire beneficial ownership within 60 days.

Shares of common stock subject to options, warrants or convertible securities exercisable or convertible within 60 days of the date hereof are deemed outstanding for computing the percentage of the person or entity holding such options, warrants or convertible securities but are not deemed outstanding for computing the percentage of any other person. To the best of our knowledge, subject to community and martial property laws, all persons named have sole voting and investment power with respect to such shares, except as otherwise noted. Percentage of class based upon 16,792,239 shares of our common stock outstanding as of September 30, 2010.

	Common Stock Beneficially Owned Prior to Offering		Common Stock Beneficially Owned After the Offering	
Name and Address of Beneficial Owners(1)	**Number**	**Percent**	**Number**	**Percent**
Baowen Ren(2)	3,272,855	19.31%	3,272,855	14.60%
Wen (Wendy) Fu(3)	10,000	*	10,000	*
Hon Wan Chan	10,000	*	10,000	*
Peng Zhou	750,000	4.47%	750,000	3.37%
Wenjie Zhang	20	*	20	*
Albert Ching-Hwa Pu		0%		
Zidong Cao		0%		
Investwide(4)	2,241,229	12.80%	2,241,229	9.75%
Concentra Trust ITF Paragon Managed Accounts(5)	1,857,161	10.68%	1,857,161	8.13%
Trillion Growth China LP(6)	1,563,737	9.03%	1,563,737	6.86%
All officers and directors as a group (7 total)	4,042,875	23.84%	4,042,875	18.03%

* less than 1%

(1) Unless otherwise noted, the address for each of the named beneficial owners is: Room 1502, Building D, Wangzou International City Building, No. 3 Tangyuan Road, Gaoxin District, Xi'an, Shaanxi Province, People's Republic of China.

(2) Consist of 157,895 shares of our common stock issuable upon the exercise of Series B Warrants beneficially owned by Mr. Ren.

(3) Represents options to acquire 10,000 shares of common stock.

(4) Consists of 280,702 shares of common stock and 197,368 shares of our common stock issuable upon the exercise of Series B Warrants held by Investwide LLC and 1,236,843 shares of our common stock and 526,316 shares of our common stock issuable upon the exercise of Series B Warrants held by Investwide Capital LLC. Mr. Yong Li is the Managing Director of Investwide LLC and Investwide Capital LLC and has voting and dispositive power over all shares held by these entities. The address of Investwide LLC and Investwide Capital LLC is 32 Broadway, Suite 1701, New York, New York 10004.

(5) Consists of 1,264,450 shares of common stock and 592,711 shares of our common stock issuable upon the exercise of Series B Warrants. Paradigm Portfolio Management Corporation, as a portfolio manager of the stockholder, has voting and dispositive power over the shares held by Concentra Trust ITF Paradigm Managed Accounts, and claims such beneficial ownership. Kyle Kozuska is the President of Paradigm Portfolio Management Corporation. The address for Paradigm Portfolio Management Corporation is 300-110 21st Street E., Saskatoon, SK, CAN, S7K 0B6.

(6) Consists of 1,034,965 shares of common stock and 528,772 shares of our common stock issuable upon the exercise of Series A Warrants and Series B Warrants. The limited partners of Trillion Growth China LP have voting and dispositive power over the shares held by the stockholder, and they can be deemed to beneficially own such shares. The address for Trillion Growth China LP is 10th Floor, Bankers Hall West Tower, Calgary, Alberta,

T2P 5C5, Canada.

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DESCRIPTION OF CAPITAL STOCK

The following is a summary description of our capital stock and certain provisions of our articles of incorporation and by-laws, copies of which have been filed as exhibits to this prospectus. The following discussion is qualified in its entirety by reference to such exhibits.

General

We are authorized to issue 30,000,000 shares of common stock, par value $0.001 per share, and 50,000,000 shares of preferred stock, par value $0.001 per share.

As of September 30, 2010, we had 16,792,239 shares of common stock issued and outstanding.

The following is a summary of the material terms of our capital stock.

Common Stock

Voting: The holders of common stock are entitled to one vote per share on all matters to be voted on by the stockholders. Our common stock has no cumulative voting rights.

Dividends: The holders of our common stock are entitled to receive such dividends, if any, as may be declared from time to time by our board of directors, in its discretion, from funds legally available therefor.

Liquidation: In the event of liquidation or dissolution of the Company, the holders of our common stock are entitled to receive, pro rata, assets remaining available for distribution to stockholders.

No Preemptive Rights: Our common stock has no cumulative voting, preemptive or subscription rights and is not subject to any future calls.

Preferred Stock

We are authorized to issue 50,000,000 shares of preferred stock. Our board of directors is expressly authorized to provide for the issuance of all or any of the shares of the preferred stock in one or more series, and to fix the number of shares and to determine or alter, for each such series, such voting powers, full or limited, or no voting powers, and such designations, preferences, and relative, participating optional, or other rights and such qualifications, limitations, or restrictions thereof, as shall be stated and expressed in the resolution or resolutions adopted by the board of directors providing for the issuance of such shares and as may be permitted by the Nevada Revised Statutes. The board of directors is also expressly authorized to increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series subsequent to the issue of shares of that series. In case the number of shares of any such series shall be so decreased, the shares constituting such decrease shall resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series.

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Warrants

Series A Warrants

We have issued Series A Warrants to purchase up to 603,303 shares of common stock in aggregate at an initial exercise price of $1.50 per share, subject to adjustments to a exercise price no lower than $0.50 per share. The Series A Warrants are exercisable until October 31, 2011.

In addition, Ancora Securities, Inc. was issued a warrant to purchase up to 35,710 shares of common stock as a finders fee in connection with our 2008 financing, at an exercise price of $2.50 per share, which was exercised in 2010.

Series B Warrants

We have issued Series B Warrants to purchase up to 2,603,158 shares of common stock in aggregate at an initial exercise price of $2.85 per share. In the event that we issue additional equity, equity linked securities or securities convertible into equity, at a purchase price less than the then applicable exercise price of the Series B Warrants, the exercise price shall be reduced to the purchase price at which such additional issuance was made.

In addition, Axiom Capital Management, Inc. was initially issued a warrant to purchase up to 427,074 shares of common stock as an investment banking commission in connection with our 2009 financing, at an exercise price of $2.28 per share.

Transfer Agent and Registrar

The transfer agent and registrar for shares of our common stock and preferred stock is Signature Stock Transfer, Inc. Our transfer agent and registrar's telephone number is (972)-612-4120.

UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

General

The following is a summary of the material U.S. federal income tax consequences to an investor of the acquisition, ownership and disposition of our common stock purchased by the investor pursuant to this offering. As used in this discussion, references to "we", "our" and "us" refer only to Sino Clean Energy Inc.

The discussion below of the U.S. federal income tax consequences to "U.S. Holders" will apply to a beneficial owner of our common stock that is for U.S. federal income tax purposes:

- an individual citizen or resident of the United States;
- a corporation (or other entity treated as a corporation) that is created or organized (or treated as created or organized) in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate whose income is includible in gross income for U.S. federal income tax purposes regardless of its source; or
- a trust if (i) a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust, or (ii) it has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If a beneficial owner of our common stock is not described as a U.S. Holder and is not an entity treated as a partnership or other pass-through entity for U.S. federal income tax purposes, such owner will be considered a "Non-U.S. Holder." The material U.S. federal income tax consequences applicable specifically to Non-U.S. Holders are described below under the heading "Non-U.S. Holders."

This summary is based on the Internal Revenue Code of 1986, as amended, or the "Code," its legislative history, Treasury regulations promulgated thereunder, published rulings and court decisions, all as currently in effect. These authorities are subject to change or differing interpretations, possibly on a retroactive basis.

This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular holder based on such holder's individual circumstances. In particular, this discussion considers only holders that will own our common stock as capital assets within the meaning of Section 1221 of the Code, and does not address the potential application of the alternative minimum tax or the U.S. federal income tax consequences to holders that are subject to special rules, including:

- financial institutions or financial services entities;
- broker-dealers;
- persons that are subject to the mark-to-market accounting rules under Section 475 of the Code;
- tax-exempt entities;
- governments or agencies or instrumentalities thereof;

insurance companies;

regulated investment companies;

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- real estate investment trusts;
- certain expatriates or former long-term residents of the United States;
- persons that actually or constructively own 5 percent or more of our voting stock;
- persons that acquired our common stock pursuant to an exercise of employee stock options, in connection with employee stock incentive plans or otherwise as compensation;
- persons that hold our common stock as part of a straddle, constructive sale, hedging, conversion or other integrated transaction; or
- persons whose functional currency is not the U.S. dollar.

This discussion does not address any aspect of U.S. federal non-income tax laws, such as gift or estate tax laws, state, local or non-U.S. tax laws or, except as discussed herein, any tax reporting obligations of a holder of our common stock. Additionally, this discussion does not consider the tax treatment of partnerships or other pass-through entities or persons who hold our common stock through such entities. If a partnership (or other entity classified as a partnership for U.S. federal income tax purposes) is the beneficial owner of our common stock, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. This discussion also assumes that any distributions made (or deemed made) by us on our common stock and any consideration received (or deemed received) by a holder in consideration for the sale or other disposition of our common stock will be in U.S. dollars.

We have not sought, and will not seek, a ruling from the Internal Revenue Service ("IRS") or an opinion of counsel as to any U.S. federal income tax consequence described herein. The IRS may disagree with the description herein, and its determination may be upheld by a court. Moreover, there can be no assurance that future legislation, regulations, administrative rulings or court decisions will not adversely affect the accuracy of the statements in this discussion.

THIS DISCUSSION IS ONLY A SUMMARY OF CERTAIN MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF OUR COMMON STOCK. IT IS NOT TAX ADVICE. EACH PROSPECTIVE INVESTOR IN OUR COMMON STOCK IS URGED TO CONSULT ITS OWN TAX ADVISOR WITH RESPECT TO THE PARTICULAR TAX CONSEQUENCES TO SUCH INVESTOR OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF OUR COMMON STOCK, INCLUDING THE APPLICABILITY AND EFFECT OF ANY STATE, LOCAL, AND NON-U.S. TAX LAWS, AS WELL AS U.S. FEDERAL TAX LAWS, AND ANY APPLICABLE TAX TREATIES.

U.S. Holders

Taxation of Distributions

A U.S. Holder generally will be required to include in gross income as ordinary income the amount of any cash dividend paid on the shares of our common stock. A cash distribution on such shares generally will be treated as a dividend for U.S. federal income tax purposes to the extent paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). The portion of such cash distribution, if any, in excess of such earnings and profits generally will constitute a return of capital that will be applied against and reduce (but not below zero) the U.S. Holder's adjusted tax basis in our common stock. Any remaining excess generally will be treated as gain from the sale or other taxable disposition of such common stock and will be treated as described under " Taxation on the Disposition of Common Stock" below.

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Any cash dividends we pay to a U.S. Holder that is treated as a taxable corporation for U.S. federal income tax purposes generally will qualify for the dividends-received deduction if the applicable holding period and other requirements are satisfied. With certain exceptions, if the applicable holding period and other requirements are satisfied, cash dividends we pay to a non-corporate U.S. Holder generally will constitute "qualified dividends" that will be subject to tax at the maximum regular tax rate accorded to long-term capital gains for tax years beginning on or before December 31, 2010, after which the regular U.S. federal income tax rate applicable to dividends is scheduled to return to the regular tax rate generally applicable to ordinary income.

If a PRC tax applies to any cash dividends paid to a U.S. Holder on our common stock, such tax should be treated as a foreign tax eligible for a deduction from such holder's U.S. federal taxable income or a foreign tax credit against such holder's U.S. federal income tax liability (subject to applicable conditions and limitations). In addition, such U.S. Holder may be entitled to certain benefits under the Agreement between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income (the "U.S.-PRC Tax Treaty"), if such holder is considered a resident of the United States for purposes of, and otherwise meets the requirements of, the U.S.-PRC Tax Treaty. U.S. Holders should consult their own tax advisors regarding the deduction or credit for any such PRC tax and their eligibility for the benefits of the U.S.-PRC Tax Treaty.

Taxation on the Disposition of Common Stock

Upon a sale or other taxable disposition of our common stock, a U.S. Holder generally will recognize capital gain or loss in an amount equal to the difference between the amount realized and the U.S. Holder's adjusted tax basis in the common stock.

The regular U.S. federal income tax rate on capital gains recognized by U.S. Holders generally is the same as the regular U.S. federal income tax rate on ordinary income, except that long-term capital gains recognized by non-corporate U.S. Holders are generally subject to U.S. federal income tax at a maximum regular rate of 15% for taxable years beginning before January 1, 2011 (but currently scheduled to increase to 20% for taxable years beginning on or after January 1, 2011). Capital gain or loss will constitute long-term capital gain or loss if the U.S. Holder's holding period for the common stock exceeds one year. The deductibility of capital losses is subject to various limitations.

If a PRC tax applies to any gain from the disposition of our common stock by a U.S. Holder, such tax should be treated as a foreign tax eligible for a deduction from such holder's U.S. federal taxable income or a foreign tax credit against such holder's U.S. federal income tax liability (subject to applicable conditions and limitations). In addition, such U.S. Holder may be entitled to certain benefits under the U.S.-PRC Tax Treaty, if such holder is considered a resident of the United States for purposes of, and otherwise meets the requirements of, the U.S.-PRC Tax Treaty. U.S. Holders should consult their own tax advisors regarding the deduction or credit for any such PRC tax and their eligibility for the benefits of the U.S.-PRC Tax Treaty.

Additional Taxes After 2012

For taxable years beginning after December 31, 2012, U.S. Holders that are individuals, estates or trusts and whose income exceeds certain thresholds generally will be subject to a 3.8% Medicare contribution tax on unearned income, including, among other things, dividends on, and capital gains from the sale or other taxable disposition of, our common stock, subject to certain limitations and exceptions. U.S. Holders should consult their own tax advisors regarding the effect, if any, of such tax on their ownership and disposition of our common stock.

Non-U.S. Holders

Taxation of Distributions

Any cash distribution we make to a Non-U.S. Holder of shares of our common stock, to the extent paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles), generally will constitute a dividend for U.S. federal income tax purposes. Unless we are treated as an "80/20 company" for U.S. federal income tax purposes, as described below, any such dividend paid to a Non-U.S. Holder with respect to shares of our common stock that is not effectively connected with the Non-U.S. Holder's conduct of a trade or business within the United States, as described below, generally will be subject to U.S. federal withholding tax at a rate of 30% of the gross amount of the dividend, unless such Non-U.S. Holder is eligible for a reduced rate of withholding tax under an applicable income tax treaty and provides proper certification of its eligibility for such reduced rate (usually on an IRS Form W-8BEN). In satisfying the foregoing withholding obligation with respect to a cash distribution, we may withhold up to 30% of either (i) the gross amount of the entire distribution, even if the amount of the distribution is greater than the amount constituting a dividend, as described above, or (ii) the amount of the distribution we project will be a dividend, based upon a reasonable estimate of both our current and our accumulated earnings and profits for the taxable year in which the distribution is made. If U.S. federal income tax is withheld on the amount of a distribution in excess of the amount constituting a dividend, the Non-U.S. Holder may obtain a refund of all or a portion of the excess amount withheld by timely filing a claim for refund with the IRS. Any such distribution not constituting a dividend generally will be treated, for U.S. federal income tax purposes, first as reducing the Non-U.S. Holder's adjusted tax basis in its shares of our common stock (but not below zero) and, to the extent such distribution exceeds the Non-U.S. Holder's adjusted tax basis, as gain from the sale or other disposition of the common stock, which will be treated as described under " Taxation on the Disposition of Common Stock" below.

There is a possibility that we may qualify as an "80/20 company" for U.S. federal income tax purposes. In general, a U.S. corporation is an 80/20 company if at least 80% of its gross income earned directly or from subsidiaries during an applicable testing period is "active foreign business income." The 80% test is applied on a periodic basis. If we qualify as an 80/20 company, a percentage of any dividend paid by us generally will not be subject to U.S. federal withholding tax. However, the current 80/20 company rules generally have been repealed for tax years beginning on or after January 1, 2011. A Non-U.S. Holder should consult with its own tax advisors regarding the amount of any such dividend subject to withholding tax in this circumstance.

Cash dividends we pay to a Non-U.S. Holder that are effectively connected with such Non-U.S. Holder's conduct of a trade or business within the United States (and, if certain income tax treaties apply, are attributable to a U.S. permanent establishment or fixed base maintained by the Non-U.S. Holder) generally will not be subject to U.S. withholding tax, provided such Non-U.S. Holder complies with certain certification and disclosure requirements (usually by providing an IRS Form W-8ECI). Instead, such dividends generally will be subject to U.S. federal income tax (but not the Medicare contribution tax), net of certain deductions, at the same regular U.S. federal income tax rates applicable to a comparable U.S. Holder. If the Non-U.S. Holder is a corporation, such dividends that are effectively connected income may also be subject to a "branch profits tax" at a rate of 30% (or such lower rate as may be specified by an applicable income tax treaty).

Taxation on the Disposition of Common Stock

A Non-U.S. Holder generally will not be subject to U.S. federal income tax in respect of gain recognized on a sale, exchange or other disposition of our common stock, unless:

- the gain is effectively connected with the conduct of a trade or business by the Non-U.S. Holder within the United States (and, under certain income tax treaties, is attributable to a U.S. permanent establishment or fixed base maintained by the Non-U.S. Holder);

- the Non-U.S. Holder is an individual who is present in the United States for 183 days or more in the taxable year of disposition and certain other conditions are met; or

- we are or have been a "United States real property holding corporation" ("USRPHC") for U.S. federal income tax purposes at any time during the shorter of the five year period ending on the date of disposition or the Non-U.S. Holder's holding period for the common stock disposed of, and, generally, in the case where our common stock is regularly traded on an established securities market, the Non-U.S. Holder has owned, directly or indirectly, more than 5% of our common stock at any time during the shorter of the five year period ending on the date of disposition or the Non-U.S. Holder's holding period for the common stock disposed of. There can be no assurance that our common stock will be treated as regularly traded on an established securities market for this purpose.

Unless an applicable tax treaty provides otherwise, gain described in the first and third bullet points above generally will be subject to U.S. federal income tax (but not the Medicare contribution tax), net of certain deductions, at the same regular U.S. federal income tax rates applicable to a comparable U.S. Holder. Any gains described in the first bullet point above of a Non-U.S. Holder that is a foreign corporation may also be subject to an additional "branch profits tax" at a 30% rate (or a lower applicable tax treaty rate). Any U.S. source capital gain of a Non-U.S. Holder described in the second bullet point above (which may be offset by U.S. source capital losses during the taxable year of the disposition) generally will be subject to a flat 30% U.S. federal income tax rate (or a lower applicable tax treaty rate).

In connection with the third bullet point above, we generally will be classified as a USRPHC if (looking through certain subsidiaries) the fair market value of our "United States real property interests" equals or exceeds 50% of the sum of the fair market value of our worldwide real property interests plus our other assets used or held for use in a trade or business, as determined for U.S. federal income tax purposes. Based on the current composition of the assets of us and our subsidiaries, we believe that we currently are not a USRPHC, and we do not anticipate becoming a USRPHC (although no assurance can be given that we will not become a USRPHC in the future). Non-U.S. Holders, particularly those Non-U.S. Holders that could be treated as actually or constructively holding more than 5% of our common stock, should consult their own tax advisors regarding the U.S. federal income tax consequences of owning and disposing of our common stock.

Payments After 2012

Effective generally for payments made after December 31, 2012, a Non-U.S. Holder may be subject to a U.S. federal withholding tax at a 30% rate with respect to dividends on, and the gross proceeds from the sale or other disposition of, our common stock if certain disclosure requirements related to the U.S. accounts maintained by, or the U.S. ownership of, the Non-U.S. Holder are not satisfied. If payment of such withholding taxes is required, a Non-U.S. Holder that is otherwise eligible for an exemption from, or a reduction of, U.S. withholding taxes with respect to such dividends and proceeds generally will be required to seek a refund from the IRS to obtain the benefit of such exemption or reduction. Non-U.S. Holders should consult their own tax advisors regarding the effect, if any, of such withholding taxes on their ownership and disposition of our common stock.

Information Reporting and Backup Withholding

We generally must report annually to the IRS and to each holder the amount of dividends and certain other distributions we pay to such holder on our common stock and the amount of tax, if any, withheld with respect to those distributions. In the case of a Non-U.S. Holder, copies of the information returns reporting those distributions and withholding may also be made available to the tax authorities in the country in which the Non-U.S. Holder is a resident under the provisions of an applicable income tax treaty or agreement. Information reporting is also generally required with respect to proceeds from the sales and other dispositions of our common stock to or through the U.S. office (and in certain cases, the foreign office) of a broker.

In addition, backup withholding of U.S. federal income tax, at a rate of 28% for taxable years beginning before January 1, 2011 (but currently scheduled to increase to 31% for taxable years beginning on or after January 1, 2011), generally will apply to distributions made on our common stock to, and the proceeds from sales and other dispositions of our common stock by, a non-corporate U.S. Holder who:

- fails to provide an accurate taxpayer identification number;
- is notified by the IRS that backup withholding is required; or
- in certain circumstances, fails to comply with applicable certification requirements.

A Non-U.S. Holder generally may eliminate the requirement for information reporting (other than with respect to distributions, as described above) and backup withholding by providing certification of its foreign status, under penalties of perjury, on a duly executed applicable IRS Form W-8 or by otherwise establishing an exemption.

Backup withholding is not an additional tax. Rather, the amount of any backup withholding will be allowed as a credit against a U.S. Holder's or a Non-U.S. Holder's U.S. federal income tax liability and may entitle such holder to a refund, provided that certain required information is timely furnished to the IRS. Holders are urged to consult their own tax advisors regarding the application of backup withholding and the availability of and procedures for obtaining an exemption from backup withholding in their particular circumstances.

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PRC INCOME TAX CONSIDERATIONS

The following is a summary of the material PRC income tax consequences to an investor of the acquisition, ownership and disposition of our common stock purchased by the investor pursuant to this offering. As used in this discussion, references to "we", "our" and "us" refer only to Sino Clean Energy Inc.

Resident Enterprise Treatment

On March 16, 2007, the Fifth Session of the Tenth National People's Congress passed the Enterprise Income Tax Law of the PRC ("EIT Law"), which became effective on January 1, 2008. Under the EIT Law, enterprises are classified as "resident enterprises" and "non-resident enterprises." Pursuant to the EIT Law and its implementing rules, enterprises established outside China whose "de facto management bodies" are located in China are considered "resident enterprises" and subject to the uniform 25% enterprise income tax rate on their worldwide taxable income. According to the implementing rules of the EIT Law, "de facto management body" refers to a managing body that in practice exercises substantial and overall management and control over the production and business, personnel, accounting and assets of an enterprise.

On April 22, 2009, the State Administration of Taxation ("SAT") issued the Notice on the Issues Regarding Recognition of Chinese-Invested/Controlled Foreign Enterprises Resident Enterprises Based on the De Facto Management Body Criteria, which was retroactively effective as of January 1, 2008. This notice provides that an overseas incorporated enterprise that is controlled by Chinese enterprise(s) will be recognized as a "non-domestic registration tax-resident enterprise" if it satisfies all of the following conditions: (i) the senior management responsible for daily production/business operations are primarily located in the PRC, and the location(s) where such senior management execute their responsibilities are primarily in the PRC; (ii) strategic financial and personnel decisions are made or approved by organizations or personnel located in the PRC; (iii) major properties, accounting ledgers, company seals and minutes of board meetings and stockholder meetings, etc., are maintained in the PRC; and (iv) 50% or more of the board members with voting rights or senior management habitually reside in the PRC.

Given the short history of the EIT Law and lack of applicable legal precedent, it remains unclear how the PRC tax authorities will determine the resident enterprise status of a company organized under the laws of a foreign (non-PRC) jurisdiction, such as us and/or Wiscon. If the PRC tax authorities determine that we and/or Wiscon are a "resident enterprise" for PRC enterprise income tax purposes, a number of tax consequences could follow. First, we and/or Wiscon could be subject to the enterprise income tax at a rate of 25% on our and/or Wiscon's worldwide taxable income, as well as PRC enterprise income tax reporting obligations. Second, the EIT Law provides that dividend income between "qualified resident enterprises" is exempt from income tax. As a result, if we and Wiscon are each treated as "qualified resident enterprises," all dividends paid from Suoke Clean Energy to us (through Wiscon) should be exempt from PRC tax.

As of the date of this prospectus, there has not been a definitive determination by us, Wiscon or the PRC tax authorities as to the "resident enterprise" or "non-resident enterprise" status of us or Wiscon. However, since it is not anticipated that we and/or Wiscon would receive dividends or generate other income in the near future, we and Wiscon are not expected to have any income that would be subject to the 25% enterprise income tax on worldwide taxable income in the near future. We and/or Wiscon will make any necessary tax payment if we or Wiscon (based on future clarifying guidance issued by the PRC), or the PRC tax authorities, determine that we or Wiscon are a resident enterprise under the EIT Law, and if we or Wiscon were to have income in the future.

Dividends From Suoke Clean Energy

If Wiscon is not treated as a resident enterprise under the EIT Law, then dividends that Wiscon receives from Suoke Clean Energy may be subject to a 10% PRC withholding tax pursuant to the EIT Law and the implementing rules of the EIT Law.

Due to the short history of the EIT Law and lack of applicable legal precedents, the PRC tax authorities may determine the resident enterprise status of entities organized under the laws of foreign jurisdictions on a case-by-case basis. We and Wiscon are holding companies and substantially all of our income and that of Wiscon may be derived from dividends. Thus, if we and/or Wiscon are considered a "non-resident enterprise" under the EIT Law and the dividends paid to us and/or Wiscon are considered income sourced within the PRC, such dividends received may be subject to PRC withholding tax as described in the foregoing paragraph.

The State Council of the PRC or a tax treaty between China and the jurisdiction in which the non-resident enterprise resides may reduce or exempt such income or withholding tax payable by, a non-resident enterprise. Pursuant to the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the "PRC-Hong Kong Tax Treaty") and relevant circulars issued by SAT, if the Hong Kong resident enterprise owns more than 25% of the equity interest in a PRC resident enterprise and is determined as a beneficial owner of the dividends, the 10% PRC withholding tax on the dividends the Hong Kong resident enterprise receives from the PRC resident enterprise may be reduced to 5%.

We are a U.S. holding company which owns 100% of the outstanding shares of a subsidiary in Hong Kong (Wiscon), which in turns owns a 100% equity interest in Suoke Clean Energy, a PRC company. As a result, if Wiscon were treated as a "non-resident enterprise" under the EIT Law, then dividends that Wiscon receives from Suoke Clean Energy (assuming such dividends were considered sourced within the PRC) (i) may be subject to a 5% PRC withholding tax, if the PRC-Hong Kong Tax Treaty were applicable, or (ii) if such treaty does not apply (i.e., because the PRC tax authorities may deem Wiscon to be a conduit and not a beneficial owner and thus not entitled to treaty benefits), may be subject to a 10% PRC withholding tax. Similarly, if we were treated as a "non-resident enterprise" under the EIT Law and Wiscon were treated as a "resident enterprise" under the EIT Law, then dividends that we receive from Wiscon (assuming such dividends were considered sourced within the PRC) may be subject to a 10% PRC withholding tax. Any such taxes on dividends could materially reduce the amount of dividends, if any, that we could pay to our shareholders.

As of the date of this prospectus, there has not been a definitive determination as to the "resident enterprise" or "non-resident enterprise" status of us or Wiscon. As described above, however, Suoke Clean Energy and Wiscon are not expected to pay any dividends in the near future. Suoke Clean Energy and Wiscon, as the case may be, will make any necessary tax withholding if, in the future, Suoke Clean Energy or Wiscon were to pay any dividends and Suoke Clean Energy or Wiscon (based on future clarifying guidance issued by the PRC), or the PRC tax authorities, determine that Wiscon is or we are a non-resident enterprise under the EIT Law.

Dividends that Non-PRC Resident Investors Receive From Us; Gain on the Sale or Transfer of Our Common Stock

If we are determined to be a resident enterprise under the EIT Law and dividends payable to (or gains realized by) our investors that are not tax residents of the PRC ("non-resident investors") are treated as income derived from sources within the PRC, then the dividends that non-resident investors receive from us and any such gain derived by them on the sale or transfer of our common stock may be subject to income tax under the PRC tax laws.

Under the EIT Law and its implementing rules, PRC withholding tax at the rate of 10% is applicable to dividends payable to non-resident investors which are enterprises (but not individuals) and which (i) do not have an establishment or place of business in the PRC or (ii) have an establishment or place of business in the PRC but the relevant income is not effectively connected with the establishment or place of business, to the extent that such dividends are deemed to be sourced within the PRC. Similarly, any gain realized on the transfer of our common stock by such investors is also subject to 10% PRC income tax if such gain is regarded as income derived from sources within the PRC.

Under the PRC Individual Income Tax Law and its implementing rules, a 20% PRC withholding tax is applicable to dividends payable to non-resident investors who are individuals, to the extent that such dividends are deemed to be sourced within the PRC. Similarly, any gain realized on the transfer of our common stock by such investors is also subject to 20% PRC income tax if such gain is regarded as income derived from sources within the PRC.

The dividends paid by us to non-resident investors with respect to our common stock, or gain non-resident investors may realize from the sale or transfer of our common stock, may be treated as PRC-sourced income and, as a result, may be subject to PRC income tax. In such event, we may be required to withhold the applicable PRC income tax on any dividends paid to non-resident investors. In addition, non-resident investors in our common stock may be responsible for paying the applicable PRC income tax on any gain realized from the sale or transfer of our common stock if such non-resident investors and the gain satisfy the requirements under the PRC tax laws. However, under the PRC tax laws, we would not have an obligation to withhold PRC income tax in respect of the gains that non-resident investors (including U.S. investors) may realize from the sale or transfer of our common stock.

If we were to pay any dividends in the future, and if we (based on future clarifying guidance issued by the PRC), or the PRC tax authorities, determine that we must withhold PRC tax on any dividends payable by us under the PRC tax laws, we will make any necessary tax withholding on dividends payable to our non-resident investors. If non-resident investors as described under the PRC tax laws (including U.S. investors) realize any gain from the sale or transfer of our common stock and if such gain were considered as PRC-sourced income, such non-resident investors would be responsible for paying the applicable PRC income tax on the gain from the sale or transfer of our common stock. As indicated above, under the PRC tax laws, we would not have an obligation to withhold PRC income tax in respect of the gains that non-resident investors (including U.S. investors) may realize from the sale or transfer of our common stock.

If any such PRC income tax is imposed on a non-resident investor, the non-resident investor may be entitled to a reduced rate of PRC tax under the applicable income tax treaty and/or a deduction for such PRC tax against such investor's domestic taxable income or a foreign tax credit in respect of

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such PRC tax against such investor's domestic income tax liability (subject to applicable conditions and limitations).

On December 10, 2009, the SAT released Circular Guoshuihan No. 698 ("Circular 698") that reinforces the taxation of certain equity transfers by non-resident investors through overseas holding vehicles. Circular 698 addresses indirect equity transfers as well as other issues. Circular 698 is retroactively effective from January 1, 2008. According to Circular 698, where a non-resident investor that indirectly holds an equity interest in a PRC resident enterprise through a non-PRC offshore holding company indirectly transfers an equity interest in a PRC resident enterprise by selling an equity interest in the offshore holding company, and the latter is located in a country or jurisdiction where the actual tax burden is less than 12.5 percent or where the offshore income of its residents is not taxable, the non-resident investor is required to provide the PRC tax authority in charge of that PRC resident enterprise with certain relevant information within 30 days from the date of the execution of the equity transfer agreement. The responsible tax authorities will evaluate the offshore transaction for tax purposes. In the event that the PRC tax authorities determine that such transfer is an abuse of forms of business organization and a reasonable commercial purpose for the offshore holding company other than the avoidance of PRC income tax liability is lacking, the PRC tax authorities will have the power to re-assess the nature of the equity transfer under the doctrine of substance over form. If the SAT's challenge of a transfer is successful, it may deny the existence of the offshore holding company that is used for tax planning purposes and subject the non-resident investor to PRC tax on the capital gain from such transfer. Since Circular 698 has a short history, there is uncertainty as to its application. We (or a non-resident investor) may become at risk of being taxed under Circular 698 and may be required to expend valuable resources to comply with Circular 698 or to establish that we (or such non-resident investor) should not be taxed under Circular 698, which could have a material adverse effect on our financial condition and results of operations (or such non-resident investor's investment in us).

Penalties for Failure to Pay Applicable PRC Income Tax

A non-resident investor in us may be responsible for paying PRC income tax on any gain realized from the sale or transfer of our common stock if we are determined to be a PRC resident enterprise under the EIT Law and such gain is treated as PRC sourced income under the PRC tax laws, as described above.

According to the EIT Law and its implementing rules, the PRC Tax Administration Law (the "Tax Administration Law") and its implementing rules, the Provisional Measures for the Administration of Withholding of Enterprise Income Tax for Non-Resident Enterprises (the "Administration Measures") and other applicable PRC laws or regulations (collectively the "Tax Related Laws"), where any gain derived by a non-resident investor from the sale or transfer of our common stock is subject to any income tax in the PRC, and such non-resident investor, if determined to be a taxpayer under the Tax Related Laws, fails to file any tax return or pay tax in this regard pursuant to the Tax Related Laws, such investor may be subject to certain fines, penalties or punishments, including without limitation: (1) if such non-resident investor fails to file a tax return and present the relevant information in connection with tax payments, the competent PRC tax authorities may order it to rectify within the prescribed time limit and may impose a fine up to RMB 2,000, and in egregious cases, may impose a fine ranging from RMB 2,000 to RMB 10,000; (2) if such non-resident investor fails to file a tax return and fails to pay all or part of the amount of tax payable, the non-resident investor may be required to pay the unpaid tax amount payable, a surcharge on overdue tax payments (the daily surcharge is 0.05% of the overdue amount, beginning from the day the deferral begins) and a fine ranging from 50% to 500% of the unpaid amount of the tax payable;

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(3) if such non-resident investor fails to file a tax return and to pay the tax within the prescribed time limit according to the order by the PRC tax authorities, the PRC tax authorities may collect and check information about the income receivable by the non-resident investor in the PRC from other payers (the "Other Payers") who will pay amounts to such non-resident investor, and send a "Notice of Tax Issues" to the Other Payers to collect and recover the tax payable and overdue fines imposed on such non-resident investor from the amounts otherwise payable to such non-resident investor by the Other Payers; (4) if such non-resident investor fails to pay the tax payable within the prescribed time limit as ordered by the PRC tax authorities, a fine may be imposed on the non-resident investor ranging from 50% to 500% of the unpaid tax payable, and the PRC tax authorities may, upon approval by the director of the tax bureau (or sub-bureau) of, or higher than, the county level, take the following compulsory measures: (i) notify in writing the non-resident investor's bank or other financial institution to withhold from the account thereof for payment of the amount of tax payable, and (ii) detain, seal off, or sell by auction or on the market the non-resident investor's commodities, goods or other property in a value equivalent to the amount of tax payable; or (5) if such non-resident investor fails to pay all or part of the amount of tax payable or the surcharge for the overdue tax payment, and can not provide a guarantee to the PRC tax authorities, the tax authorities may notify the frontier authorities to prevent the non-resident investor or its legal representative from leaving the PRC.

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UNDERWRITING

We are offering the shares of common stock described in this prospectus through Rodman & Renshaw, LLC and Axiom Capital Management, Inc. Rodman & Renshaw, LLC and Axiom Capital Management, Inc. are acting as representatives of the underwriters of the offering. We have entered into an underwriting agreement dated December 21, 2010 with the underwriters. Subject to the terms and conditions of the underwriting agreement, we have agreed to sell to the underwriters, and each underwriter has agreed to purchase, at the public offering price less the underwriting discounts and commissions set forth on the cover page of this prospectus, the number of shares of common stock listed next to its name in the following table:

Name	Number of Shares
Rodman & Renshaw, LLC	2,732,500
Axiom Capital Management, Inc.	2,732,500
Total	5,465,000

The underwriters are committed to purchase all the shares of common stock offered by us other than those covered by the option to purchase additional shares described below, if they purchase any shares. The obligations of the underwriters may be terminated upon the occurrence of certain events specified in the underwriting agreement. Furthermore, pursuant to the underwriting agreement, the underwriters' obligations are subject to customary conditions, representations and warranties contained in the underwriting agreement, such as receipt by the underwriters of officers' certificates and legal opinions.

Our common stock is quoted on the NASDAQ Global Market under the symbol "SCEI." On December 21, 2010, the closing market price of our common stock was $5.67 per share.

The underwriters propose to offer the common stock directly to the public at the public offering price set forth on the cover page of this prospectus and to certain dealers that are members of the Financial Industry Regulatory Authority, or FINRA, at that price less a concession not in excess of $0.2205 per share. Any such dealers may resell shares to certain other brokers or dealers at a discount of up to $0.05 per share from the public offering price. After the public offering of the shares, the offering price and other selling terms may be changed by the underwriters.

The following table shows the per share and total underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering.

	Per Share	Total Without Over-Allotment Option	Total With Over-Allotment Option
Public offering price	$ 5.2500	$ 28,691,250,000	$ 32,994,937.50
Underwriting discount	$ 0.3675	$ 2,008,387.50	$ 2,309,645.62
Proceeds, before expenses, to us	$ 4.8825	$ 26,682,862.50	$ 30,685,291.88

We estimate that the total expenses of this offering, including registration, filing and listing fees, printing fees and legal and accounting expenses, but excluding the underwriting discounts and commissions, will be approximately $1,108,131. In compliance with guidelines of FINRA, the maximum compensation or discount to be received by any participating FINRA members or independent broker dealers in connection with the offer and sale of any securities will not be greater than 7.0% of the aggregate amount of the securities offered pursuant to this prospectus.

We have agreed to reimburse the underwriters for all reasonable fees and expenses of the underwriters' legal counsel and for all other reasonable out-of-pocket expenses incurred in connection with this offering up to an aggregate amount not to exceed 2.0% of the offering proceeds.

Overallotment Option

We have granted a 45-day option to the underwriters to purchase up to an additional 819,750 shares of common stock sold on the date hereof, at the same price as the initial shares offered. If the underwriters fully exercise this option, the total public offering price (before expenses) and net proceeds to us will be approximately $32,995,000, and $29,577,000, respectively, based on the public offering price of $5.25 per share.

A prospectus in electronic format may be made available on the web sites maintained by the underwriters, or selling group members, if any, participating in the offering. The underwriters may agree to allocate a number of shares to selling group members for sale to their online brokerage account holders. Internet distributions will be allocated by the underwriters to selling group members that may make Internet distributions on the same basis as other allocations.

Lock-ups

We have agreed that we will not for a period of one hundred eighty (180) days from the effective date of the registration statement of which this prospectus is a part, (i) offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of, directly or indirectly, any shares of capital stock or any securities convertible into or exercisable or exchangeable for shares of capital stock; (ii) file or caused to be filed any registration statement with the Securities and Exchange Commission relating to the offering of any shares of capital stock or any securities convertible into or exercisable or exchangeable for shares of capital stock, or (iii) enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of capital stock, whether any such transaction described in clause (i), (ii) or (iii) above is to be settled by delivery of shares of capital stock or such other securities, in cash or otherwise, other than the shares to be sold hereunder, and shares issuable upon the exercise or conversion of outstanding securities, securities issued under any company stock or equity compensation plans.

Our directors and executive officers, and certain of our significant stockholders (with respect to 92.5% of the shares owned by such significant stockholders), have entered into lock-up agreements with the underwriters prior to the commencement of this offering pursuant to which each of these persons or entities, for a period of one hundred eighty (180) days (with respect to directors and executive officers) or ninety (90) days (with respect to significant stockholders) after the date of this prospectus, may not, without the prior written consent of the underwriters, (1) offer, pledge, sell, contract to sell, grant, lend, or otherwise transfer or dispose of, directly or indirectly, any shares of our common stock or any securities convertible into or exercisable or exchangeable for shares of our common stock, or (2) enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of the common stock, whether any such transaction described in clause (1) or (2) above is to be settled by delivery of common stock or such other securities, in cash or otherwise.

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The restrictions described in the preceding paragraph do not apply to certain exceptions, including the following:

- the shares of our common stock to be sold pursuant to the underwriting agreement;
- the issuance of shares of common stock upon the exercise of an option or warrant or similar security or the conversion of a security outstanding on the date of the underwriting agreement of which the underwriters have been advised in writing;
- the issuance of options or shares of our capital stock under any of our stock or equity compensation plan;
- transferring the shares to the underwriters pursuant to the underwriting agreement; or
- transferring the shares as a bona fide gift, or by will or intestacy, and to immediate family; provided that such transferees agree to be bound by the lock-up.

The 180-day or 90-day, as applicable, lock-up period described in the preceding paragraphs will be automatically extended if: (1) during the last 17 days of such restricted period, we issue an earnings release or announce material news or a material event; or (2) prior to the expiration of such lock-up period, we announce that we will release earnings results during the 16-day period beginning on the last day of such lock-up period, in which case the restrictions described in the preceding paragraph will continue to apply until the expiration of the 18-day period beginning on the date of the earnings release or the date of the occurrence of the material news or material event.

Stabilization

In connection with this offering, the underwriters may engage in stabilizing transactions, which involve making bids for, purchasing and selling shares of common stock in the open market for the purpose of preventing or retarding a decline in the market price of the common stock while this offering is in progress. These stabilizing transactions may include making short sales of the common stock, which involves the sale by the underwriters of a greater number of shares of common stock than they are required to purchase in this offering, and purchasing shares of common stock on the open market to cover positions created by short sales. Short sales may be "covered" shorts or may be "naked" shorts. The underwriters may close out any covered short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market that could adversely affect investors who purchase in this offering. To the extent that the underwriters create a naked short position, it will purchase shares in the open market to cover the position.

The underwriters have advised us that, pursuant to Regulation M promulgated under the Securities Act, it may also engage in other activities that stabilize, maintain or otherwise affect the price of the common stock, including the imposition of penalty bids. This means that if the representatives of the underwriters purchase common stock in the open market in stabilizing transactions or to cover short sales, the representatives can require the underwriters that sold those shares as part of this offering to repay the underwriting discount received by them.

These activities may have the effect of raising or maintaining the market price of the common stock or preventing or retarding a decline in the market price of the common stock, and, as a result, the price of the common stock may be higher than the price that otherwise might exist in the open market. If the underwriters commence these activities, they may discontinue them at any time. The underwriters may carry out these transactions on the NASDAQ Global Market, in the over-the-counter market or otherwise.

Prior to this offering, there has only been a limited market for our common stock, which until June 11, 2010 was traded on the OTCBB under the symbol "SCLX." On June 14, 2010, our shares were listed on the NASDAQ Global Market under the symbol "SCEI." Because there has not been an effective trading market of substance for our common stock to date, however, the offering price for shares offered hereby, which was negotiated by us and the underwriters, may not necessarily reflect the last reported sale price for our common stock or the market price of our common stock following the offering. In determining the public offering price, we and the underwriters expect to consider a number of factors including:

- the information set forth in this prospectus and otherwise available to the underwriters;
- our prospects and the history and prospects for the industry in which we compete;
- an assessment of our management;
- our prospects for future earnings;
- the general condition of the securities markets at the time of this offering;
- the recent market prices of, and demand for, publicly traded common stock of generally comparable companies; and
- other factors deemed relevant by the underwriter and us.

Neither we, nor the underwriters can assure investors that an active trading market will develop for our common stock, or that the shares will trade in the public market at or above the public offering price.

Persons into whose possession this prospectus comes are advised to inform themselves about and to observe any restrictions relating to the offering and the distribution of this prospectus. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities offered by this prospectus in any jurisdiction in which such an offer or a solicitation is unlawful.

Other Terms

In connection with this offering, the underwriters and certain of the securities dealers may distribute prospectuses electronically. No forms of prospectus other than printed prospectuses and electronically distributed prospectuses that are printable in Adobe PDF format will be used in connection with this offering.

The underwriters and their affiliates may provide from time to time in the future certain commercial banking, financial advisory, investment banking and other services for us and our affiliates in the ordinary course of their business, for which they may receive customary fees and commissions. We previously issued warrants to purchase up to 427,074 shares of common stock at an exercise price of $2.28 per share, to Axiom Capital Management, Inc. on October 28, 2009, as an investment banking commission in connection with our private placement of convertible notes.

From time to time, the underwriters and their affiliates may effect transactions for their own account or the account of customers, and hold on behalf of themselves or their customers, long or short positions in our debt or equity securities or loans, and may do so in the future.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933, or the Securities Act.

We have also agreed to issue to Axiom Capital Management, Inc., warrants to purchase an aggregate 2.5% of the number of shares sold in this offering at an exercise price of 125% of the offering price of the shares sold in this offering, or $6.5625 per share. The warrants will expire five (5) years from the effective date of the registration statement. In addition, the warrant is not redeemable by us, and allows for "cashless" exercise. The warrant also provides for unlimited "piggyback" registration rights at our expense with respect to the underlying common stock during the five (5)-year period commencing on the effective date and fully complies with Rule 5110(f)(2)(H) including restrictions on anti-dilution terms.

Pursuant to the rules of FINRA, and in particular Rule 5110(g)(1), the warrant (and underlying common stock) issued to Axiom Capital Management, Inc. may not be sold, transferred, assigned, pledged, or hypothecated, or the subject of any hedging, short sale, derivative, put or call transaction that would result in the effective disposition of the securities by any person for a period of 180 days immediately following the date of effectiveness of the registration statement; provided, however, that the warrant (and underlying common stock) may be transferred to officers or partners of Axiom Capital Management, Inc. as long as the warrants (and underlying common stock) remain subject to the lock-up agreement.

Foreign Regulatory Restrictions on Purchase of the Common Stock

No action may be taken in any jurisdiction other than the United States that would permit a public offering of the common stock or the possession, circulation or distribution of this prospectus in any country or jurisdiction where action for that purpose is required. Accordingly, the common stock may not be offered or sold, directly or indirectly, and neither the prospectus nor any other offering material or advertisements in connection with the common stock may be distributed or published in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

In addition to the public offering of the shares in the United States, the underwriters may, subject to the applicable foreign laws, also offer the common shares to certain institutions or accredited persons in the following countries:

Australia. If this document is issued or distributed in Australia it is issued or distributed to "wholesale clients" only, not to "retail clients". For the purposes of this paragraph, the terms "wholesale client" and "retail client" have the meanings given in section 761 of the Australian Corporations Act 2001 (Cth). This document is not a disclosure document under the Australian Corporations Act, has not been lodged with the Australian Securities & Investments Commission and does not purport to include the information required of a disclosure document under the Australian Corporations Act. Accordingly, (i) the offer of securities under this document is only made to persons to whom it is lawful to offer such securities under one or more exemptions set out in the Australian

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Corporations Act, (ii) this document is only made available in Australia to those persons referred to in clause (i) above, and (iii) the offeree must be sent a notice stating in substance that, by accepting this offer, the offeree represents that the offeree is such a person as referred to in clause (i) above, and, unless permitted under the Australian Corporations Act, agrees not to sell or offer for sale within Australia any of the securities sold to the offeree within 12 months after its transfer to the offeree under this document.

China. THIS PROSPECTUS HAS NOT BEEN AND WILL NOT BE CIRCULATED OR DISTRIBUTED IN THE PRC, AND SHARES MAY NOT BE OFFERED OR SOLD, AND WILL NOT BE OFFERED OR SOLD TO ANY PERSON FOR RE-OFFERING OR RESALE, DIRECTLY OR INDIRECTLY, TO ANY RESIDENT OF THE PRC EXCEPT PURSUANT TO APPLICABLE LAWS AND REGULATIONS OF THE PRC.

UAE. The offering has not been approved or licensed by the Central Bank of the United Arab Emirates (the "UAE"), Securities and Commodities Authority of the UAE and/or any other relevant licensing authority in the UAE including any licensing authority incorporated under the laws and regulations of any of the free zones established and operating in the territory of the UAE, in particular the Dubai Financial Services Authority (the "DFSA"), a regulatory authority of the Dubai International Financial Centre (the "DIFC").

The offering does not constitute a public offer of securities in the UAE, DIFC and/or any other free zone in accordance with the Commercial Companies Law, Federal Law No. 8 of 1984 (as amended), DFSA Offered Securities Rules and NASDAQ Dubai Listing Rules, accordingly, or otherwise. The securities offered hereby may not be offered to the public in the UAE and/or any of the free zones, including, in particular, the DIFC.

The securities offered hereby may be offered and issued only to a limited number of investors in the UAE or any of its free zones (including, in particular, the DIFC) who qualify as sophisticated investors under the relevant laws and regulations of the UAE or the free zone concerned, including, in particular, the DIFC.

The company represents and warrants that the securities offered hereby will not be offered, sold, transferred or delivered to the public in the UAE or any of its free zones, including, in particular, the DIFC."

Dubai. The issuer is not licensed by the Dubai Financial Services Authority ("DFSA") to provide financial services in the Dubai International Financial Centre ("DIFC"). The offering has not been approved or licensed by the Central Bank of the United Arab Emirates (the "UAE"), Securities and Commodities Authority of the UAE and/or any other relevant licensing authority in the UAE including any licensing authority incorporated under the laws and regulations of any of the free zones established and operating in the territory of the UAE, in particular the DFSA, a regulatory of the DIFC.

The offering does not constitute a public offer of securities in the UAE, DIFC and/or any other free zone in accordance with the Commercial Companies Law, Federal Law No. 8 of 1984 (as amended), DFSA Offered Securities Rules and NASDAQ Dubai Listing Rules, accordingly, or otherwise. The securities offered hereby may not be offered to the public in the UAE and/or any of the free zones, including, in particular, the DIFC.

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The securities offered hereby may be offered and issued only to a limited number of investors in the UAE or any of its free zones (including, in particular, the DIFC) who qualify as sophisticated investors under the relevant laws and regulations of the UAE or the free zone concerned, including, in particular, the DIFC.

The company represents and warrants that the securities offered hereby will not be offered, sold, transferred or delivered to the public in the UAE or any of its free zones, including, in particular, the DIFC.

Israel. The common stock offered by this prospectus has not been approved or disapproved by the Israeli Securities Authority (the ISA), or ISA, nor has such common stock been registered for sale in Israel. The shares may not be offered or sold, directly or indirectly, to the public in Israel, absent the publication of a prospectus. The ISA has not issued permits, approvals or licenses in connection with the offering or publishing the prospectus; nor has it authenticated the details included herein, confirmed their reliability or completeness, or rendered an opinion as to the quality of the common stock being offered. Any resale, directly or indirectly, to the public of the common stock offered by this prospectus is subject to restrictions on transferability and must be effected only in compliance with the Israeli securities laws and regulations.

Pakistan. The investors/subscribers in Pakistan will be responsible for ensuring their eligibility to invest under the applicable laws of Pakistan and to obtain any regulatory consents if required for such purpose.

Saudi Arabia. NO OFFERING OF SHARES IS BEING MADE IN THE KINGDOM OF SAUDI ARABIA, AND NO AGREEMENT RELATING TO THE SALE OF THE SHARES WILL BE CONCLUDED IN SAUDI ARABIA. THIS DOCUMENT IS PROVIDED AT THE REQUEST OF THE RECIPIENT AND IS BEING FORWARDED TO THE ADDRESS SPECIFIED BY THE RECIPIENT. NEITHER THE AGENT NOR THE OFFERING HAVE BEEN LICENSED BY THE SAUDI'S SECURITIES AND EXCHANGE COMMISSION OR ARE OTHERWISE REGULATED BY THE LAWS OF THE KINGDOM OF SAUDI ARABIA.

THEREFORE, NO SERVICES RELATING TO THE OFFERING, INCLUDING THE RECEIPT OF APPLICATIONS AND/OR THE ALLOTMENT OF THE SHARES, MAY BE RENDERED WITHIN THE KINGDOM BY THE AGENT OR PERSONS REPRESENTING THE OFFERING.

UK. The content of this Memorandum has not been issued or approved by an authorised person within the meaning of the United Kingdom Financial Services and Markets Act 2000 ("FSMA"). Reliance on this Memorandum for the purpose of engaging in any investment activity may expose an Investor to a significant risk of losing all of the property or other assets invested. This prospectus does not constitute a prospectus within the meaning of the FSMA and is issued in reliance upon one or more of the exemptions from the need to issue such a prospectus contained in section 86 of the FSMA.

LEGAL MATTERS

The validity of the securities offered hereby has been passed upon for us by Lionel Sawyer & Collins, Las Vegas, Nevada. Certain legal matters in connection with this offering will be passed upon for us by Loeb & Loeb LLP, New York, New York. In addition, legal matters relating to the PRC in connection with this offering will be passed upon for us by AllBright Law Offices, Shanghai, PRC. DLA Piper LLP (US), Boston, Massachusetts is acting as U.S. counsel to the underwriters in this offering. Jun He Law Offices, Beijing, PRC, is acting as PRC counsel to the underwriters in this offering.

EXPERTS

The consolidated financial statements of Sino Clean Energy, Inc. and Subsidiaries as of December 31, 2009 and 2008, and for each of the two years in the period ended December 31, 2009, appearing in this prospectus and in the registration statement have been audited by Weinberg & Company, P.A., independent registered public accounting firm, as set forth in their report thereon, appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

SERVICE OF PROCESS AND ENFORCEMENT OF JUDGMENTS

Some of our directors and officers reside in the PRC and substantially all of our assets are located in the PRC. In addition, certain "experts" named in this prospectus are located in the PRC. As a result, it may be difficult or impossible for you to effect service of process on our officers and directors or those experts within the United States.

AllBright Law Offices, our counsel as to PRC law, has advised us that there is uncertainty as to whether the courts of the PRC would (1) recognize or enforce judgments of United States courts obtained against our officers or directors or the experts named in this prospectus based on the civil liability provisions of the securities laws of the United States or any state in the United States, or (2) entertain original actions brought in the PRC against our officers or directors or the experts named in this prospectus based on the securities laws of the United States or any state in the United States.

DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION OF SECURITIES ACT LIABILITIES

Our bylaws provide that we will indemnify our directors and officers to the extent required by the Nevada Revised Statute and shall indemnify such individuals to the extent permitted by the Nevada Revised Statute.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons, we have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by us of expenses incurred or paid by a director, officer or controlling person in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by us is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

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WHERE YOU CAN FIND MORE INFORMATION

We have filed with the United States Securities and Exchange Commission, 100 F. Street, N.E., Washington, D.C. 20549, a registration statement on Form S-1 under the Securities Act for the common stock offered by this prospectus. We have not included in this prospectus all the information contained in the registration statement and you should refer to the registration statement and its exhibits for further information.

The registration statement and other information may be read and copied at the SEC's Public Reference Room at 100 F. Street N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a web site (http://www.sec.gov) that contains the registration statements, reports, proxy and information statements and other information regarding registrants that file electronically with the SEC such as us.

You may also read and copy any reports, statements or other information that we have filed with the SEC at the addresses indicated above and you may also access them electronically at the web site set forth above. These SEC filings are also available to the public from commercial document retrieval services.

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Sino Clean Energy Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	September 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 34,348,096	$ 18,302,558
Accounts receivable, net	3,550,690	3,655,473
Inventories	1,334,722	892,609
Prepaid inventories	5,644,695	5,453,095
Prepaid expenses	1,365	259,627
Tax recoverable		138,495
Other receivables	55,774	65,584
Land use right current portion	39,474	38,739
Total current assets	44,974,816	28,806,180
Property, plant and equipment, net	15,063,481	12,557,691
Land use right non current portion	1,782,624	1,778,562
Goodwill	762,018	762,018
Prepayments and deposits	3,656,117	729,328
Total assets	$ 66,239,056	$ 44,633,779
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current liabilities		
Accounts payable and accrued expenses	$ 3,361,796	$ 2,672,211
Taxes payable	2,259,303	1,577,249
Amount due to directors	73,456	73,466
Mortgage payable current portion	5,282	
Derivative liabilities	19,101,337	16,752,858
Total current liabilities	24,801,174	21,075,784
Mortgage payable non current portion	158,292	
Convertible notes, net of discount		1,615,025
Derivative liabilities		28,404,181
Total liabilities	24,959,466	51,094,990
Commitments and Contingencies		
Shareholders' Equity (Deficiency)		
Preferred stock, $0.001 par value, 50,000,000 shares authorized, none issued and outstanding		
Common stock, $0.001 par value, 30,000,000 shares authorized, 16,792,239 and 10,850,613 issued and outstanding as of September 30, 2010 and December 31, 2009 respectively	16,792	10,850
Additional paid-in capital	37,805,971	25,432,804
Accumulated deficit	(790,260)	(35,802,987)
Statutory reserves	1,758,553	1,758,553
Accumulated other comprehensive income	2,488,534	2,139,569
Total Shareholders' equity (deficiency)	41,279,590	(6,461,211)

Total liabilities and shareholders' equity (deficiency)	$	66,239,056	$	44,633,779

See accompanying notes to condensed consolidated financial statements.

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Sino Clean Energy Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Other Comprehensive Income

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Revenue	$ 24,913,134	$ 10,889,796	$ 73,571,899	$ 26,982,573
Cost of goods sold	(15,269,720)	(6,812,469)	(44,448,913)	(17,695,505)
Gross profit	9,643,414	4,077,327	29,122,986	9,287,068
Selling expenses	1,156,147	416,585	3,203,245	422,405
General and administrative expenses	579,837	471,664	1,925,072	1,452,975
Income from operations	7,907,430	3,189,078	23,994,669	7,411,688
Other income (expense)				
Interest and finance costs	(1,047)	(3,149,499)	(10,459,201)	(4,231,344)
Expense related to escrow shares		(1,054,548)		(1,294,881)
Interest income	29,889	11,708	62,113	22,979
Gain on extinguishment of derivative liability		2,381,333	28,404,181	3,370,593
Change in fair value of derivative liabilities	(970,813)	(7,035,248)	(2,348,479)	(8,236,238)
Cost of private placement		(24,794,842)		(24,794,842)
Sundry expense	(4,688)			
Total other income (expense)	(946,659)	(33,641,096)	15,658,614	(35,163,733)
Income (loss) before provision for income taxes	6,960,771	(30,452,018)	39,653,283	(27,752,045)
Provision for income taxes	1,349,424	463,050	4,640,556	1,055,718
Net income (loss)	5,611,347	(30,915,068)	35,012,727	(28,807,763)
Other comprehensive income				
Foreign currency translation adjustment	67,493	3,578	348,965	12,932
Comprehensive income (loss)	$ 5,678,840	$ (30,911,490)	$ 35,361,692	$ (28,794,831)
Weighted average number of shares				
Basic	16,703,844	10,041,910	15,385,062	9,609,130
Diluted	18,780,537	10,041,910	18,668,856	9,609,130
Income (loss) per common share				
Basic	$ 0.34	$ (3.08)	$ 2.28	$ (3.00)
Diluted	$ 0.30	$ (3.08)	$ 1.88	$ (3.00)

See accompanying notes to condensed consolidated financial statements.

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Sino-Clean Energy Inc. and Subsidiaries

Condensed Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

For the nine months ended September 30, 2010

(Unaudited)

	Common stock		Additional paid-in capital	Statutory reserves	Accumulated Deficit	Accumulated other comprehensive income	Total
	Shares	Amount					
Balance, January 1, 2010	10,850,613	$ 10,850	$ 25,432,804	$ 1,758,553	$ (35,802,987)	$ 2,139,569	$ (6,461,211)
Shares issued upon exercise of warrants and options	297,871	298	262,958				263,256
Fair value of vested options			34,152				34,152
Shares issued upon conversion of notes payable	5,643,755	5,644	12,076,057				12,081,701
Foreign currency translation gain						348,965	348,965
Net income					35,012,727		35,012,727
Balance, September 30, 2010 (unaudited)	16,792,239	$ 16,792	$ 37,805,971	$ 1,758,553	$ (790,260)	$ 2,488,534	$ 41,279,590

See accompanying notes to condensed consolidated financial statements.

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Sino Clean Energy Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine months ended September 30, 2010	2009
Cash flows from operating activities:		
Net income (loss)	$ 35,012,727	$ (28,807,763)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	1,593,325	1,098,914
Amortization of deferred debt issuance costs		274,278
Amortization of discount on convertible notes	8,601,975	3,873,979
Fair value of common stock issued for payment of interest expense	1,864,701	
Expense related to escrow shares		1,294,881
Fair value of common stock issued for services		454,935
Cost of private placement		24,794,842
Gain on extinguishment of derivative liabilities	(28,404,181)	(3,370,593)
Change in fair value of derivative liabilities	2,348,479	8,236,238
Fair value of vested options	34,152	
Change in operating assets and liabilities:		
Accounts receivable	171,480	(1,563,019)
Other receivables	10,884	(7,812)
Inventories	(418,740)	(435,105)
Prepaid inventories	(86,835)	(2,167,975)
Prepaid expenses	258,262	27,191
Tax recoverable	138,984	
Refundable advance		731,861
Government grant receivable		146,314
Accounts payable and accrued expenses	(491,938)	37,982
Taxes payable	644,310	483,921
Net cash provided by operating activities	21,277,585	5,103,069
Cash flows from investing activities:		
Prepayments and deposits	(2,239,737)	(3,733,408)
Loans receivable		(540,365)
Purchase of property, plant and equipment	(2,621,605)	(29,767)
Net cash used in investing activities	(4,861,342)	(4,303,540)
Cash flows from financing activities:		
Proceeds from issuance of convertible debentures		11,592,000
Cost of private placement paid in cash		(1,543,152)
Redemption of convertible debenture		(400,000)
Prepayments and deposits related to deferred offering costs	(652,053)	
Proceeds from mortgage payable		

we recorded $10,780 and $7,821, respectively, of interest costs and amortization of financing costs on the Public Notes as interest expense.

Prospect Capital InterNotes®

On February 16, 2012, we entered into a selling agent agreement (the “Selling Agent Agreement”) with Incapital LLC, as purchasing agent for our issuance and sale from time to time of up to $500,000 of Prospect Capital InterNotes® (the “InterNotes® Offering”), which was increased to $1,500,000 in May 2014. Additional agents may be appointed by us from time to time in connection with the InterNotes® Offering and become parties to the Selling Agent Agreement.

These notes are direct unsecured obligations and rank equally with all of our unsecured indebtedness from time to time outstanding. Each series of notes will be issued by a separate trust. These notes bear interest at fixed interest rates and offer a variety of maturities no less than twelve months from the original date of issuance.

During the three months ended September 30, 2016, we issued $38,917 aggregate principal amount of Prospect Capital InterNotes® for net proceeds of $38,435. These notes were issued with stated interest rates ranging from 5.00% to 5.50% with a weighted average interest rate of 5.42%. These notes mature between July 15, 2021 and September 15, 2021.
During the three months ended September 30, 2015, we issued $48,134 aggregate principal amount of our Prospect Capital InterNotes® for net proceeds of $47,381. These notes were issued with stated interest rates ranging from 4.63% to 5.25% with a weighted average interest rate of 5.06%. These notes mature between July 15, 2020 and March 15, 2022. The following table summarizes the Prospect Capital InterNotes® issued during the three months ended September 30, 2015.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate		Maturity Date Range
5	$ 17,784	4.63%–4.75%	4.74	%	July 15, 2020 – September 15, 2020
6.5	30,350	5.10%–5.25%	5.24	%	January 15, 2022 – March 15, 2022
	$ 48,134		0.051		

During the three months ended September 30, 2016, we repaid $1,979 aggregate principal amount of Prospect Capital InterNotes® at par in accordance with the Survivor's Option, as defined in the InterNotes® Offering prospectus. As a result of these transactions, we recorded a loss in the amount of the difference between the reacquisition price and the net carrying amount of the notes, net of the proportionate amount of unamortized debt issuance costs. The net loss on the extinguishment of Prospect Capital InterNotes® in the three months ended September 30, 2016 was $61. The following table summarizes the Prospect Capital InterNotes® outstanding as of September 30, 2016.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate		Maturity Date Range
3	$5,710	4.00%	4.00	%	October 15, 2016
3.5	3,109	4.00%	4.00	%	April 15, 2017
4	45,690	3.75%–4.00%	3.92	%	November 15, 2017 – May 15, 2018
5	297,916	4.25%–5.50%	5.01	%	July 15, 2018 – September 15, 2021
5.2	4,440	4.63%	4.63	%	August 15, 2020 – September 15, 2020
5.3	2,686	4.63%	4.63	%	September 15, 2020
5.4	5,000	4.75%	4.75	%	August 15, 2019
5.5	109,718	4.25%–5.00%	4.65	%	February 15, 2019 – November 15, 2020
6	2,197	3.38%	3.38	%	April 15, 2021 – May 15, 2021
6.5	40,817	5.10%–5.50%	5.24	%	February 15, 2020 – May 15, 2022
7	192,016	4.00%–6.55%	5.13	%	June 15, 2019 – December 15, 2022
7.5	1,996	5.75%	5.75	%	February 15, 2021
10	37,519	3.85%–7.00%	6.13	%	March 15, 2022 – December 15, 2025
12	2,978	6.00%	6.00	%	November 15, 2025 – December 15, 2025
15	17,325	5.25%–6.00%	5.36	%	May 15, 2028 – November 15, 2028
18	22,238	4.13%–6.25%	5.53	%	December 15, 2030 – August 15, 2031
20	4,452	5.63%–6.00%	5.89	%	November 15, 2032 – October 15, 2033
25	35,015	6.25%–6.50%	6.39	%	August 15, 2038 – May 15, 2039
30	114,924	5.50%–6.75%	6.23	%	November 15, 2042 – October 15, 2043
	$945,746				

During the three months ended September 30, 2015, we repaid $628 aggregate principal amount of Prospect Capital InterNotes® at par in accordance with the Survivor's Option, as defined in the InterNotes® Offering prospectus. As a result of these transactions, we recorded a loss in the amount of the difference between the reacquisition price and the net carrying amount of the notes, net of the proportionate amount of unamortized debt issuance costs. The net loss on the extinguishment of Prospect Capital InterNotes® in the three months ended September 30, 2015 was $15.

The following table summarizes the Prospect Capital InterNotes® outstanding as of June 30, 2016.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate		Maturity Date Range
3	$5,710	4.00%	4.00	%	October 15, 2016
3.5	3,109	4.00%	4.00	%	April 15, 2017
4	45,690	3.75%–4.00%	3.92	%	November 15, 2017 – May 15, 2018
5	259,191	4.25%–5.75%	4.95	%	July 15, 2018 – June 15, 2021
5.20	4,440	4.63%	4.63	%	August 15, 2020 – September 15, 2020
5.3	2,686	4.63%	4.63	%	September 15, 2020
5	5,000	4.75%	4.75	%	August 15, 2019
5.5	109,808	4.25%–5.00%	4.65	%	February 15, 2019 – November 15, 2020
6	2,197	3.38%	3.38	%	April 15, 2021 – May 15, 2021
6.5	40,867	5.10%–5.50%	5.24	%	February 15, 2020 – May 15, 2022
7	192,076	4.00%–6.55%	5.13	%	June 15, 2019 – December 15, 2022
8	1,996	5.75%	5.75	%	February 15, 2021
10	37,533	3.62%–7.00%	6.11	%	March 15, 2022 – December 15, 2025
12	2,978	6.00%	6.00	%	November 15, 2025 – December 15, 2025
15	17,325	5.25%–6.00%	5.36	%	May 15, 2028 – November 15, 2028
18	22,303	4.13%–6.25%	5.53	%	December 15, 2030 – August 15, 2031
20	4,462	5.63%–6.00%	5.89	%	November 15, 2032 – October 15, 2033
25	35,110	6.25%–6.50%	6.39	%	August 15, 2038 – May 15, 2039
30	116,327	5.50%–6.75%	6.23	%	November 15, 2042 – October 15, 2043
	$908,808				

In connection with the issuance of Prospect Capital InterNotes®, we incurred $22,797 of fees which are being amortized over the term of the notes, of which $14,932 remains to be amortized and is included as a reduction within Prospect Capital InterNotes® on the Consolidated Statement of Assets and Liabilities as of September 30, 2016. During the three months ended September 30, 2016 and September 30, 2015, we recorded $13,213 and $11,706 , respectively, of interest costs and amortization of financing costs on the Prospect Capital InterNotes® as interest expense.

Net Asset Value

During the three months ended September 30, 2016, our net asset value was stable on a dollars basis and decreased by $0.02 per share, primarily due to distributions to our shareholders exceeding net investment income. Our net investment income decreased primarily from a decrease in interest and other income following the sale of Harbortouch in May 2016. This decrease was partially offset by the increased earnings from new non-control investments during three months ended September 30, 2016 and lower management fees. The following table shows the calculation of net asset value per share as of September 30, 2016 and June 30, 2016.

	September 30, 2016	June 30, 2016
Net assets	$3,435,609	$3,435,917
Shares of common stock issued and outstanding	358,042,158	357,107,231
Net asset value per share	$9.60	$9.62

Results of Operations

Net increase in net assets resulting from operations for the three months ended September 30, 2016 and September 30, 2015 was $81,366 and $27,817. During the three months ended September 30, 2016 the $53,549 increase is primarily due to a $65,918 favorable increase in net realized and unrealized losses on investments when comparing results for the three months ended September 30, 2016 and September 30, 2015. This $65,918 increase is due to a favorable decrease in unrealized losses on our investments.

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While we seek to maximize gains and minimize losses, our investments in portfolio companies can expose our capital to risks greater than those we may anticipate. These companies typically do not issue securities rated investment grade, and have limited resources, limited operating history, and concentrated product lines or customers. These are generally private companies with limited operating information available and are likely to depend on a small core of management talents. Changes in any of these factors can have a significant impact on the value of the portfolio company.

Investment Income

We generate revenue in the form of interest income on the debt securities that we own, dividend income on any common or preferred stock that we own, and fees generated from the structuring of new deals. Our investments, if in the form of debt securities, will typically have a term of one to ten years and bear interest at a fixed or floating rate. To the extent achievable, we will seek to collateralize our investments by obtaining security interests in our portfolio companies' assets. We also may acquire minority or majority equity interests in our portfolio companies, which may pay cash or in-kind dividends on a recurring or otherwise negotiated basis. In addition, we may generate revenue in other forms including prepayment penalties and possibly consulting fees. Any such fees generated in connection with our investments are recognized as earned.

Investment income, which consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including settlement of net profits interests, overriding royalty interests and structuring fees, was $179,832 and $200,251 for the three months ended September 30, 2016 and September 30, 2015, respectively. Investment income decreased during the three months ended September 30, 2016 as compared to the three months ended September 30, 2015 primarily due to a decrease in interest income. The following table describes the various components of investment income and the related levels of debt investments:

	Three Months Ended September 30,	
	2016	2015
Interest income	$171,650	$191,303
Dividend income	2,384	3,215
Other income	5,798	5,733
Total investment income	$179,832	$200,251
Average debt principal of performing investments	$5,688,154	$6,385,514
Weighted average interest rate earned on performing debt and equity investments	12.07 %	11.98 %

Average interest income producing assets decreased from $6,385,514 for the three months ended September 30, 2015 to $5,688,154 for the three months ended September 30, 2016. The average interest earned on interest bearing performing assets increased from 11.98% for the three months ended September 30, 2015 to 12.07% for the three months ended September 30, 2016. This increase is primarily due to repayments of lower yielding portfolio investments.

Investment income is also generated from dividends and other income which is less predictable than interest income. Dividend income decreased from $3,215 for the three months ended September 30, 2015 to $2,384 for the three months ended September 30, 2016. The $831 decrease in dividend income is primarily attributed to an overall decrease in the level of dividends received from our controlled portfolio investments. The level of dividends received from our investment in CCPI decreased $2,659 during the three months ended September 30, 2016 as compared to the same period in the prior year. This decrease in dividend income was partially offset by an increase in the level of dividends received from our investment in Nationwide of $1,485 during the three months ended September 30, 2016 as compared to the same period in the prior year.

Other income has come primarily from structuring fees, which are generated from originations and will fluctuate as levels of originations and types of originations fluctuate. Income from other sources was $5,798 and $5,733 for the three months ended September 30, 2016 and September 30, 2015, respectively, holding consistent at approximately $0.02 per weighted average shares outstanding. Included within other income is $4,476 and $3,642 of structuring fees for the three months ended September 30, 2016 and 2015, respectively, consistent with a comparable level of originations. Total originations were $347,150 and $345,743 for the three months ended September 30, 2016 and September 30, 2015, respectively.

Operating Expenses

Our primary operating expenses consist of investment advisory fees (base management and income incentive fees), borrowing costs, legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for us. Our investment advisory fees compensate the Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions. Operating expenses were $100,913 and $109,009 for the three months ended September 30, 2016 and September 30, 2015, respectively.

The net base management fee was $30,792 and $32,954 for the three months ended September 30, 2016 and September 30, 2015, respectively. The changes are directly related to the level of our total assets.

The Investment Adviser has entered into a servicing agreement with certain institutions, where we serve as the agent and collect a servicing fee on behalf of the Investment Adviser. We received payments of $548 and $462 from these institutions for the three months ended September 30, 2016 and September 30, 2015, respectively, on behalf of the Investment Adviser for providing such services under the servicing agreement. We were given a credit for these payments as a reduction of base management fee payable by us to the Investment Adviser resulting in net total base management fees of $30,792 and $32,954 for the three months ended September 30, 2016 and September 30, 2015, respectively. The total gross base management fee incurred to the favor of the Investment Adviser was $31,340 and $33,416 for the three months ended September 30, 2016 and September 30, 2015, respectively.

For the three months ended September 30, 2016 and September 30, 2015, we incurred $19,730 and $22,810 of income incentive fees, respectively. For the three months ended September 30, 2016, the pre-incentive fee net investment income was $0.28 per weighted average share ($0.04 less than three months ended September 30, 2015) due to a year over year decrease in interest income primarily due a decrease in interest and other income due to repayments on investments and a decrease in interest income due to increased default rates in the underlying collateral of our CLO investments. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three months ended September 30, 2016 and September 30, 2015, we incurred $41,669 and $41,957, respectively, of interest expenses related to our Revolving Credit Facility, Convertible Notes, Public Notes and Prospect Capital InterNotes® (collectively, our "Notes"). These expenses are related directly to the leveraging capacity put into place for each of those years and the levels of indebtedness actually undertaken in those years.

The table below describes the various expenses of our Notes and the related indicators of leveraging capacity and indebtedness during these years.

	Three Months Ended September 30,			
	2016		2015	
Interest on borrowings	$35,714		$37,316	
Amortization of deferred financing costs	3,634		3,556	
Accretion of discount on Public Notes	64		49	
Facility commitment fees	2,257		1,036	
Total interest and credit facility expenses	$41,669		$41,957	
Average principal debt outstanding	$2,667,420		$2,956,726	
Weighted average stated interest rate on borrowings(1)	5.36	%	5.05	%
Weighted average interest rate on borrowings(2)	6.25	%	5.68	%

(1) Includes only the stated interest expense.

(2) Includes the stated interest expense, amortization of deferred financing costs, accretion of discount on Public Notes and commitment fees on the undrawn portion of our Revolving Credit Facility.

Interest expense is relatively stable for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015. The weighted average stated interest rate on borrowings (excluding amortization, accretion and undrawn

facility fees) increased from 5.05% for the three months ended September 30, 2015 to 5.36% for the three months ended September 30, 2016. This increase is primarily due to issuances of the 2024 Notes at higher rates.
The allocation of gross overhead expense from Prospect Administration was $4,871 and $5,876 for the three months ended September 30, 2016 and 2015, respectively. Prospect Administration received estimated payments of $1,338 and $1,698 directly from our portfolio companies and certain funds managed by the Investment Adviser for legal, tax and portfolio level accounting services during the three months ended September 30, 2016 and 2015, respectively. We were given a credit for these payments as a reduction of the administrative services cost payable by us to Prospect Administration, resulting in net overhead expense of $3,533 and $4,178 during the three months ended September 30, 2016 and 2015, respectively. Had Prospect Administration not received these payments, Prospect Administration's charges for its administrative services would have increased by these amounts.

Total operating expenses, net of investment advisory fees, interest and credit facility expenses, allocation of overhead from Prospect Administration ("Other Operating Expenses") was $5,189 and $7,110 for the three months ended September 30, 2016 and September 30, 2015, respectively. The decrease of $1,921 during the three months ended September 30, 2016 is primarily due to a decrease in other general and administrative expenses from tax related expenses in our controlled companies.

Net Investment Income

Net investment income represents the difference between investment income and operating expenses. Net investment income was $78,919 and $91,242 and for three months ended September 30, 2016 and September 30, 2015, respectively. Net investment income for three months ended September 30, 2016 and September 30, 2015 was $0.22 and $0.26 per weighted average share, respectively. During the three months ended September 30, 2016, the decrease is primarily due to a $19,653 , or $0.06 per weighted average share, decrease in interest and other income due to repayments on investments and a decrease in interest income due to increased default rates in the underlying collateral of our CLO investments. This decrease was offset by a $5,242, or $0.02 per weighted average share, decrease in total advisory fees.

Net Realized Gains/Losses

During the three months ended September 30, 2016, we recognized a net realized gain of $714, as compared to the $2,135 of net realized losses recognized during three months ended September 30, 2015. The net realized gain during the three months ended September 30, 2016 was primarily due to the receipt of bankruptcy proceeds from our investment in New Century Transportation, Inc. of $936, as well as from the sales of our investments in Biotronic, Big Tex and Nathan's for which we recognized total realized gains of $514. These gains were offset by the write-off of defaulted loans in our small business lending portfolio of $740.

Net Change in Unrealized Gains (Losses)

Net change in unrealized gains (losses) was $1,794 and $(61,275) for the three months ended September 30, 2016 and September 30, 2015, respectively. The variability in results is primarily due to the valuation of equity positions in our controlled company portfolio susceptible to significant changes in value, both increases as well as decreases, due to operating results. For the three months ended September 30, 2016, the $1,794 change in net unrealized gains was driven primarily due to improved operating performance in our controlled companies comprising $13,366 of total net change in unrealized gains, along with certain non-controlled investments - Pacific World Corporation, LaserShip, Capstone Logistics Acquisition, Inc., and Arctic Glacier - comprising $12,093 of total net change in unrealized gains. These combined unrealized gains were partially offset by unrealized losses in our CLO portfolio primarily due to a slight increase in defaults and ratings migration in the underlying collateral and an increase in the LIBOR rate.
For the three months ended September 30, 2015, the $(61,275) net change in unrealized losses was primarily the result of market fluctuations and the competitive environment faced by our energy-related companies. Unrealized losses on our CLO debt and equity investments comprised $13,053 of total net change in unrealized losses, and unrealized losses on our energy-related investments comprised $9,100 of total net change in unrealized losses for the three months ended September 30, 2015. Additionally, during the three months ended September 30, 2015, we reduced the value of our investment in Harbortouch by $17,290 due to then current market developments and our investment in LaserShip by $4,418 due to declining operating results. The value of our investment in Echelon decreased by $8,388

due to an early lease termination for one aircraft. Due to an increase in the observed market cap rate for our largest property under NPRC and an increase in the market yield for the online consumer loans, we reduced the value of our investment in NPRC by $11,025.

Financial Condition, Liquidity and Capital Resources

For the three months ended September 30, 2016 and September 30, 2015, our operating activities (used) provided $(53,833) and $244,354 of cash, respectively. There were no investing activities for the three months ended September 30, 2016 and September 30, 2015. Financing activities used $131,725 and $282,552 of cash during the three months ended September 30, 2016 and September 30, 2015, respectively, which included dividend payments of $81,596 and $85,755, respectively.

Our primary uses of funds have been to continue to invest in portfolio companies, through both debt and equity investments, repay outstanding borrowings and to make cash distributions to holders of our common stock.

Our primary sources of funds have historically been issuances of debt and equity. More recently, we have and may continue to fund a portion of our cash needs through repayments and opportunistic sales of our existing investment portfolio. We may also securitize a portion of our investments in unsecured or senior secured loans or other assets. Our objective is to put in place such borrowings in order to enable us to expand our portfolio. During the three months ended September 30, 2016, we borrowed $44,000 and did not may any repayments on the Revolving Credit Facility. As of September 30, 2016, we had, net of deferred financing cost and debt discount, $908,240 outstanding on the Convertible Notes, $736,821 outstanding on the Public Notes and $930,814 outstanding on the Prospect Capital InterNotes®, along with $44,000 outstanding on the Revolving Credit Facility. (See “Capitalization” above.)

Undrawn committed revolvers and delayed draw term loans to our portfolio companies incur commitment and unused fees ranging from 0.00% to 6.00%. As of September 30, 2016 and June 30, 2016, we had $42,484 and $40,560, respectively, of undrawn revolver and delayed draw term loan commitments to our portfolio companies. The fair value of our undrawn committed revolvers and delayed draw term loans was zero as of September 30, 2016 and June 30, 2016.

Our shareholders’ equity accounts as of September 30, 2016 and June 30, 2016 reflect cumulative shares issued, net of shares repurchased, as of those respective dates. Our common stock has been issued through public offerings, a registered direct offering, the exercise of over-allotment options on the part of the underwriters, our dividend reinvestment plan and in connection with the acquisition of certain controlled portfolio companies. When our common stock is issued, the related offering expenses have been charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by us.

As part of our Repurchase Program, we delivered a notice with our annual proxy mailing on September 23, 2015 and our most recent notice was delivered with a shareholder letter mailing on February 2, 2016. This notice extends for six months after the date that notice is delivered. We did not repurchase any shares of our common stock for the three months ended September 30, 2016. During the three months ended September 30, 2015, we repurchased 4,358,750 shares of our common stock pursuant to our publicly announced Repurchase Program for $31,530, or approximately $7.23 weighted average price per share at approximately a 30% discount to net asset value as of June 30, 2015. Our NAV per share was increased by approximately $0.04 for the three months ended September 30, 2015 as a result of the share repurchases.

On November 3, 2015, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to $4,730,685 of additional debt and equity securities in the public market as of September 30, 2016. See Recent Developments for updates to our Registration Statement subsequent to September 30, 2016.

Off-Balance Sheet Arrangements

As of September 30, 2016, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from 1) the investment advisory and management agreement and the administration agreement and 2) the portfolio companies.

Recent Developments

On October 4, 2016, we made a $40,000 second lien senior secured investment to support the recapitalization of Coinstar, LLC, an automated network of self-service coin counting machines.

On October 5, 2016, Focus Brands, Inc. repaid the $18,000 loan receivable to us.

On October 7, 2016, we made an $11,500 second lien senior secured debt investment in Dunn Paper Holdings, Inc, a leading specialty packaging supplier, in support of an acquisition of the company.

On October 14, 2016, Trinity Services Group, Inc. repaid the $134,576 loan receivable to us.
On October 14, 2016, Security Alarm Financing Enterprise, L.P. repaid the $25,000 loan receivable to us.

On October 14, 2016, Harbortouch repaid the $27,711 loan receivable to us.
On October 14, 2016, we provided $22,500 of second lien senior secured debt to support the refinancing of Vivid Seats LLC, a secondary marketplace for entertainment tickets.
On October 14, 2016, we received a partial repayment of $60,778 for the NPRC and its wholly-owned subsidiaries' loan previously outstanding and $2,222 as a return of capital on the equity investment in NPRC.
On October 20, 2016, we made a $50,000 second lien senior secured debt investment in Rocket to support an acquisition and dividend recapitalization.
On October 31, 2016, System One Holdings, LLC repaid the $104,553 loan receivable to us.
On November 1, 2016, we made a $13,000 second lien secured investment to support an acquisition of K&N Parent, Inc., a leader in aftermarket automotive performance filtration products.
On November 3, 2016, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to $5,000,000 of additional debt and equity securities in the public market.
During the period from October 1, 2016 through November 10, 2016 we issued $16,177 aggregate principal amount of Prospect Capital InterNotes® for net proceeds of $15,975.
On November 8, 2016, we announced the declaration of monthly dividends in the following amounts and with the following dates:

- $0.08333 per share for November 2016 to holders of record on November 30, 2016 with a payment date of December 22, 2016;
- $0.08333 per share for December 2016 to holders of record on December 30, 2016 with a payment date of January 19, 2017; and
- $0.08333 per share for January 2017 to holders of record on January 31, 2017 with a payment date of February 16, 2017.

Critical Accounting Policies and Estimates

Basis of Presentation and Consolidation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("GAAP") pursuant to the requirements for reporting on Form 10-Q, ASC 946, Financial Services—Investment Companies ("ASC 946"), and Articles 6, 10 and 12 of Regulation S-X. Under the 1940 Act, ASC 946, and the regulations pursuant to Article 6 of Regulation S-X, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services to benefit us. Our consolidated financial statements include the accounts of Prospect, PCF, PSBL, PYC, and the Consolidated Holding Companies. All intercompany balances and transactions have been eliminated in consolidation. The financial results of our non-substantially wholly-owned holding companies and operating portfolio company investments are not consolidated in the financial statements. Any operating companies owned by the Consolidated Holding Companies are not consolidated.

Reclassifications

Certain reclassifications have been made in the presentation of prior consolidated financial statements and accompanying notes to conform to the presentation as of and for the three months ended September 30, 2016.

Use of Estimates

The preparation of the consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of income, expenses, and gains and losses during the reported period. Changes in the economic environment, financial markets, creditworthiness of our portfolio companies and any other parameters used in determining these estimates could cause actual results to differ, and these differences could be material.

Investment Classification

We are a non-diversified company within the meaning of the 1940 Act. As required by the 1940 Act, we classify our investments by level of control. As defined in the 1940 Act, “Control Investments” are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual possesses or has the right to acquire within 60 days or less, a beneficial ownership of more than 25% of the voting securities of an investee company. Under the 1940 Act, “Affiliate Investments” are defined by a lesser degree of influence and are deemed to exist through the possession outright or via the right to acquire within 60 days or less, beneficial ownership of 5% or more of the outstanding voting securities of another person. “Non-Control/Non-Affiliate Investments” are those that are neither Control Investments nor Affiliate Investments.

Investment Transactions

Investments are recognized when we assume an obligation to acquire a financial instrument and assume the risks for gains or losses related to that instrument. Investments are derecognized when we assume an obligation to sell a financial instrument and forego the risks for gains or losses related to that instrument. Specifically, we record all security transactions on a trade date basis. Amounts for investments recognized or derecognized but not yet settled are reported in due to broker or as a receivable for investments sold, respectively, in the Consolidated Statements of Assets and Liabilities.

Investment Risks

Our investments are subject to a variety of risks. Those risks include the following:

Market Risk

Market risk represents the potential loss that can be caused by a change in the fair value of the financial instrument.

Credit Risk

Credit risk represents the risk that we would incur if the counterparties failed to perform pursuant to the terms of their agreements with us.

Liquidity Risk

Liquidity risk represents the possibility that we may not be able to rapidly adjust the size of our investment positions in times of high volatility and financial stress at a reasonable price.

Interest Rate Risk

Interest rate risk represents a change in interest rates, which could result in an adverse change in the fair value of an interest-bearing financial instrument.

Prepayment Risk

Many of our debt investments allow for prepayment of principal without penalty. Downward changes in interest rates may cause prepayments to occur at a faster than expected rate, thereby effectively shortening the maturity of the security and making us less likely to fully earn all of the expected income of that security and reinvesting in a lower yielding instrument.

Structured Credit Related Risk

CLO investments may be riskier and less transparent to us than direct investments in underlying companies. CLOs typically will have no significant assets other than their underlying senior secured loans. Therefore, payments on CLO investments are and will be payable solely from the cash flows from such senior secured loans.

Online consumer and Small and Medium Sized Business Risk

With respect to our online consumer and small and medium sized business (“SME”) lending initiative, we invest primarily in marketplace loans through marketplace lending facilitators. We do not conduct loan origination activities ourselves. Therefore, our ability to purchase consumer and SME loans, and our ability to grow our portfolio of consumer and SME loans, are directly influenced by the business performance and competitiveness of the marketplace loan origination business of the marketplace lending facilitators from which we purchase consumer and SME loans. In addition, our ability to analyze the risk-return profile of consumer and SME loans is significantly dependent on the marketplace facilitator's ability to effectively evaluate a borrower's credit profile and likelihood of default. If we are unable to effectively evaluate borrowers' credit profiles or the credit decisioning and scoring models implemented by each facilitator, we may incur unanticipated losses which could adversely impact our operating results.

Investment Valuation

To value our investments, we follow the guidance of ASC 820, Fair Value Measurement ("ASC 820"), that defines fair value, establishes a framework for measuring fair value in conformity with GAAP, and requires disclosures about fair value measurements. In accordance with ASC 820, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

ASC 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by us at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment.

Our Board of Directors has established procedures for the valuation of our investment portfolio. These procedures are detailed below.

Investments for which market quotations are readily available are valued at such market quotations.

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below.

1. Each portfolio company or investment is reviewed by our investment professionals with independent valuation firms engaged by our Board of Directors.
2. The independent valuation firms prepare independent valuations for each investment based on their own independent assessments and issue their report.
3. The Audit Committee of our Board of Directors reviews and discusses with the independent valuation firms the valuation reports, and then makes a recommendation to the Board of Directors of the value for each investment.
4. The Board of Directors discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of the Investment Adviser, the respective independent valuation firm and the Audit Committee.

Our non-CLO investments are valued utilizing a yield analysis, enterprise value ("EV") analysis, net asset value analysis, liquidation analysis, discounted cash flow analysis, or a combination of methods, as appropriate. The yield analysis uses loan spreads for loans, dividend yields for certain investments and other relevant information implied by market data involving identical or comparable assets or liabilities. Under the EV analysis, the EV of a portfolio company is first determined and allocated over the portfolio company's securities in order of their preference relative to one another (i.e., "waterfall" allocation). To determine the EV, we typically use a market multiples approach that considers relevant and applicable market trading data of guideline public companies, transaction metrics from precedent merger and acquisitions transactions and/or a discounted cash flow analysis. The net asset value analysis is used to derive a value of an underlying investment (such as real estate property) by dividing a relevant earnings stream by an appropriate capitalization rate. For this purpose, we consider capitalization rates for similar properties as may be obtained from guideline public companies and/or relevant transactions. The liquidation analysis is intended to approximate the net recovery value of an investment based on, among other things, assumptions regarding liquidation proceeds based on a hypothetical liquidation of a portfolio company's assets. The discounted cash flow analysis uses valuation techniques to convert

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future cash flows or earnings to a range of fair values from which a single estimate may be derived utilizing an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts.

In applying these methodologies, additional factors that we consider in valuing our investments may include, as we deem relevant: security covenants, call protection provisions, and information rights; the nature and realizable value of any collateral; the portfolio company's ability to make payments; the principal markets in which the portfolio company does business; publicly available financial ratios of peer companies; the principal market; and enterprise values, among other factors.

Our investments in CLOs are classified as ASC 820 Level 3 securities and are valued using a discounted cash flow model. The valuations have been accomplished through the analysis of the CLO deal structures to identify the risk exposures from the modeling point of view as well as to determine an appropriate call date (i.e., expected maturity). For each CLO security, the most appropriate valuation approach has been chosen from alternative approaches to ensure the most accurate valuation for such security. To value a CLO, both the assets and the liabilities of the CLO capital structure are modeled. Our valuation agent utilizes additional methods to validate the results from the discounted cash flow method, such as Monte Carlo simulations of key model variables, analysis of relevant data observed in the CLO market, and review of certain benchmark credit indices. We use a waterfall engine to store the collateral data, generate collateral cash flows from the assets based on various assumptions for the risk factors, distribute the cash flows to the liability structure based on the payment priorities, and discount them back using appropriate market discount rates. We are not responsible for and have no influence over the asset management of the portfolios underlying the CLO investments we hold as those portfolios are managed by non-affiliated third party CLO collateral managers. The main risk factors are: default risk, interest rate risk, downgrade risk, and credit spread risk.

Valuation of Other Financial Assets and Financial Liabilities

ASC 825, Financial Instruments, specifically ASC 825-10-25, permits an entity to choose, at specified election dates, to measure eligible items at fair value (the "Fair Value Option"). We have not elected the Fair Value Option to report selected financial assets and financial liabilities. See Note 8 in the accompanying Consolidated Financial Statements for further discussion of our financial liabilities that are measured using another measurement attribute.

Convertible Notes

We have recorded the Convertible Notes at their contractual amounts. The Convertible Notes were analyzed for any features that would require bifurcation and such features were determined to be immaterial. See Note 5 in the accompanying Consolidated Financial Statements for further discussion.

Revenue Recognition

Realized gains or losses on the sale of investments are calculated using the specific identification method.

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Loan origination fees, original issue discount, and market discounts are capitalized and accreted into interest income over the respective terms of the applicable loans using the effective interest method or straight-line, as applicable, and adjusted only for material amendments or prepayments. Upon a prepayment of a loan, prepayment premiums, OID, or market discounts are recorded as interest income. Other income generally includes amendment fees, commitment fees, administrative agent fees and structuring fees which are recorded when earned.

Loans are placed on non-accrual status when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to the cost basis depending upon management's judgment of the collectibility of the loan receivable. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, is likely to remain current. As of September 30, 2016, approximately 1.6% of our total assets at fair value are in non-accrual status.

Interest income from investments in the "equity" class of security of CLO funds (typically preferred shares, income notes or subordinated notes) and "equity" class of security of securitized trust is recorded based upon an estimation of an effective yield to expected maturity utilizing assumed cash flows in accordance with ASC 325-40, Beneficial Interests in Securitized Financial Assets. We monitor the expected cash inflows from our CLO and securitized trust equity investments, including the expected residual payments, and the effective yield is determined and updated periodically. Dividend income is recorded on the ex-dividend date.

Structuring fees and similar fees are recognized as income is earned, usually when paid. Structuring fees, excess deal deposits, net profits interests and overriding royalty interests are included in other income. See Note 10 in the accompanying Consolidated Financial Statements for further discussion.

Federal and State Income Taxes

We have elected to be treated as a RIC and intend to continue to comply with the requirements of the Code applicable to regulated investment companies. We are required to distribute at least 90% of our investment company taxable income and intend to distribute (or retain through a deemed distribution) all of our investment company taxable income and net capital gain to stockholders; therefore, we have made no provision for income taxes. The character of income and gains that we will distribute is determined in accordance with income tax regulations that may differ from GAAP. Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are reclassified to paid-in capital.

If we do not distribute (or are not deemed to have distributed) at least 98% of our annual ordinary income and 98.2% of our capital gains in the calendar year earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual ordinary income and 98.2% of our capital gains exceed the distributions from such taxable income for the year. To the extent that we determine that our estimated current year annual taxable income combined with prior year underdistributed taxable income could be in excess of estimated current year dividend distributions from such combined taxable income, we accrue excise taxes, if any, on estimated excess taxable income. As of September 30, 2016, we accrued $1,100 for any unpaid potential excise tax liability and have included this amount within other liabilities on the accompanying Consolidated Statements of Assets and Liabilities.

If we fail to satisfy the annual distribution requirement or otherwise fail to qualify as a RIC in any taxable year, we would be subject to tax on all of our taxable income at regular corporate income tax rates. We would not be able to deduct distributions to stockholders, nor would we be required to make distributions. Distributions would generally be taxable to our individual and other non-corporate taxable stockholders as ordinary dividend income eligible for the reduced maximum rate applicable to qualified dividend income to the extent of our current and accumulated earnings and profits, provided certain holding period and other requirements are met. Subject to certain limitations under the Code, corporate distributions would be eligible for the dividends-received deduction. To qualify again to be taxed as a RIC in a subsequent year, we would be required to distribute to our shareholders our accumulated earnings and profits attributable to non-RIC years. In addition, if we failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent year, we would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had been liquidated) or, alternatively, be subject to taxation on such built-in gain recognized for a period of ten years.

We follow ASC 740, Income Taxes ("ASC 740"). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. As of September 30, 2016 and for the three months then ended, we did not record any unrecognized tax benefits or liabilities. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof. Although we file both federal and state income tax returns, our major tax jurisdiction is federal. Our tax returns for our federal tax years ended August 31, 2013 and thereafter remain subject to examination by the Internal Revenue Service.

Dividends and Distributions

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a monthly dividend or distribution is approved by our Board of Directors quarterly and is generally based upon our management's estimate of our future earnings. Net realized capital gains, if any, are distributed at least annually.

Financing Costs

We record origination expenses related to our Revolving Credit Facility, and Convertible Notes, Public Notes and Prospect Capital InterNotes® (collectively, our "Unsecured Notes") as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the straight-line method over the stated life of the obligation for our Revolving Credit Facility. The same methodology is used to approximate the effective yield method for our Prospect Capital InterNotes® and our 2024 Notes Follow-on Program. The effective interest method is used for our remaining Unsecured Notes over the respective expected life or maturity. In the event that we modify or extinguish our debt before maturity, we follow the guidance in ASC 470-50, Modification and Extinguishments ("ASC 470-50"). For modifications to or exchanges of our Revolving Credit Facility, any unamortized deferred costs relating to lenders who are not part of the new lending group are expensed. For extinguishments of our Unsecured Notes, any unamortized deferred costs are deducted from the carrying amount of the debt in determining the gain or loss from the extinguishment.

For the year ending June 30, 2017, we have changed our method of presentation relating to debt issuance costs in accordance with ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30). Prior to July 1, 2016, our policy was to present debt issuance costs in Deferred financing costs as an asset on the Consolidated Statements of Assets and Liabilities, net of accumulated amortization. Beginning with the period ended September 30, 2016, we have presented these costs, except those incurred by the Revolving Credit Facility, as a direct deduction to our Unsecured Notes. Unamortized deferred financing costs of $40,526, $44,140, $57,010, $37,607, and $15,693 previously reported as an asset on the Consolidated Statements of Assets and Liabilities for the years ended June 30, 2016, 2015, 2014, 2013, and 2012, respectively, have been reclassified as a direct deduction to the respective Unsecured Notes (see Notes 5, 6, and 7 in the accompanying Consolidated Financial Statements for further discussion).

We may record registration expenses related to shelf filings as prepaid expenses. These expenses consist principally of SEC registration fees, legal fees and accounting fees incurred. These prepaid expenses are charged to capital upon the receipt of proceeds from an equity offering or charged to expense if no offering is completed. As of September 30, 2016 and June 30, 2016, there are no prepaid expenses related to registration expenses and all amounts incurred have been expensed.

Guarantees and Indemnification Agreements

We follow ASC 460, Guarantees ("ASC 460"). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual consolidated financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees.

Per Share Information

Net increase or decrease in net assets resulting from operations per share is calculated using the weighted average number of common shares outstanding for the period presented. In accordance with ASC 946, convertible securities are not considered in the calculation of net asset value per share.

Recent Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments, which clarifies the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. ASU 2016-06 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. We are currently evaluating the impact, if any, of adopting this ASU on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses certain aspects of cash flow statement classification. One such amendment requires cash payments for debt prepayment or debt extinguishment costs to be classified as cash outflows for financing activities. ASU 2016-15 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The adoption of the amended guidance in ASU 2016-15 is not expected to have a significant effect on our consolidated financial statements and disclosures.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to financial market risks, including changes in interest rates and equity price risk. Interest rate sensitivity refers to the change in our earnings that may result from changes in the level of interest rates impacting some of the loans in our portfolio which have floating interest rates. Additionally, because we fund a portion of our investments with borrowings, our net investment income is affected by the difference between the rate at which we invest and the rate at which we borrow. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. See “Risk Factors - Risks Relating to Our Business - Changes in interest rates may affect our cost of capital and net investment income” in the accompanying prospectus.

Our debt investments may be based on floating rates or fixed rates. For our floating rate loans the rates are determined from the LIBOR, EURO Interbank Offer Rate, the Federal Funds Rate or the Prime Rate. The floating interest rate loans may be subject to a LIBOR floor. Our loans typically have durations of one to three months after which they reset to current market interest rates. As of September 30, 2016, 90.1% of the interest earning investments in our portfolio, at fair value, bore interest at floating rates.

We also have a revolving credit facility and certain Prospect Capital InterNotes® issuances that are based on floating LIBOR rates. Interest on borrowings under the revolving credit facility is one-month LIBOR plus 225 basis points with no minimum LIBOR floor and there is no outstanding balance as of September 30, 2016. Interest on five Prospect Capital InterNotes® is three-month LIBOR plus a range of 350 to 300 basis points with no minimum LIBOR floor. The Convertible Notes, Public Notes and remaining Prospect Capital InterNotes® bear interest at fixed rates.

The following table shows the approximate annual impact on net investment income of base rate changes in interest rates (considering interest rate flows for floating rate instruments, excluding our investments in CLO residual interests) to our loan portfolio and outstanding debt as of September 30, 2016, assuming no changes in our investment and borrowing structure:

(in thousands) Basis Point Change	Interest Income	Interest Expense	Net Income	Net Investment Income (1)
Up 300 basis points	$92,748	$ 1,363	$91,384	$ 73,107
Up 200 basis points	54,474	909	53,565	42,852
Up 100 basis points	18,619	456	18,163	14,531
Down 100 basis points	(220)	(246)	26	21

(1) Includes the impact of income incentive fees. See Note 13 to our consolidated financial statements for the period ended
September 30, 2016 for more information on the income incentive fees.

(2) As of September 30, 2016 one and three month LIBOR was 0.53% and 0.85%, respectively.

We may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of higher interest rates with respect to our portfolio of investments. During the three months ended September 30, 2016, we did not engage in hedging activities.

REGISTRATION AND SETTLEMENT

The Depository Trust Company

All of the notes we offer will be issued in book-entry only form. This means that we will not issue certificates for notes, except in the limited case described below. Instead, we will issue global notes in registered form. Each global note will be held through DTC and will be registered in the name of Cede & Co., as nominee of DTC.

Accordingly, Cede & Co. will be the holder of record of the notes. Each note represented by a global note evidences a beneficial interest in that global note.

Beneficial interests in a global note will be shown on, and transfers are effected through, records maintained by DTC or its participants. In order to own a beneficial interest in a note, you must be an institution that has an account with DTC or have a direct or indirect account with such an institution. Transfers of ownership interests in the notes will be accomplished by making entries in DTC participants' books acting on behalf of beneficial owners.

So long as DTC or its nominee is the registered holder of a global note, DTC or its nominee, as the case may be, will be the sole holder and owner of the notes represented thereby for all purposes, including payment of principal and interest, under the indenture. Except as otherwise provided below, you will not be entitled to receive physical delivery of certificated notes and will not be considered the holder of the notes for any purpose under the indenture.

Accordingly, you must rely on the procedures of DTC and the procedures of the DTC participant through which you own your note in order to exercise any rights of a holder of a note under the indenture. The laws of some jurisdictions require that certain purchasers of notes take physical delivery of such notes in certificated form. Those limits and laws may impair the ability to transfer beneficial interests in the notes.

Each global note representing notes will be exchangeable for certificated notes of like tenor and terms and of differing authorized denominations in a like aggregate principal amount, only if (1) DTC notifies us that it is unwilling or unable to continue as depositary for the global notes or we become aware that DTC has ceased to be a clearing agency registered under the Exchange Act and, in any such case we fail to appoint a successor to DTC within 60 calendar days, (2) we, in our sole discretion, determine that the global notes shall be exchangeable for certificated notes or (3) an event of default has occurred and is continuing with respect to the notes under the indenture. Upon any such exchange, the certificated notes shall be registered in the names of the beneficial owners of the global note representing the notes.

The following is based on information furnished by DTC:

DTC will act as securities depositary for the notes. The notes will be issued as fully-registered notes registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. Generally, one fully registered global note will be issued for all of the principal amount of the notes.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues and money market instruments from over 85 countries that DTC's direct participants deposit with DTC.

DTC also facilitates the post-trade settlement among direct participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between direct participants' accounts. This eliminates the need for physical movement of securities certificates. Direct participants include both U.S. and non U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of direct participants of DTC and members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, as well as by The New York Stock Exchange, Inc., the American Stock Exchange LLC, and the Financial Industry Regulatory Authority, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a direct participant, either directly or indirectly. The DTC rules applicable to its participants are on file with the SEC. More information about DTC can be found at www.dtcc.com.

Purchases of the notes under the DTC system must be made by or through direct participants, which will receive a credit for the notes on DTC's records. The beneficial interest of each actual purchaser of each note is in turn to be recorded on the direct and indirect participants' records. Beneficial owners will not receive written confirmation from DTC of their purchase.

Beneficial owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the direct or indirect participant through which the beneficial owner entered into the transaction. Transfers of beneficial interests in the notes are to be accomplished by entries made on the books of direct and indirect participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their beneficial interests in notes, except in the event that use of the book-entry system for the notes is discontinued.

To facilitate subsequent transfers, all notes deposited by direct participants with DTC will be registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of the notes with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the notes; DTC's records reflect only the identity of the direct participants to whose accounts such notes will be credited, which may or may not be the beneficial owners. The direct and indirect participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to direct participants, by direct participants to indirect participants, and by direct participants and indirect participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial owners of the notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the notes, such as redemption, tenders, defaults, and proposed amendments to the security documents. For example, beneficial owners of the notes may wish to ascertain that the nominee holding the notes for their benefit has agreed to obtain and transmit notices to beneficial owners. In the alternative, beneficial owners may wish to provide their names and addresses to the registrar of the notes and request that copies of the notices be provided to them directly. Any such request may or may not be successful.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the notes unless authorized by a direct participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to us as soon as possible after the regular record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those direct participants to whose accounts the notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

We will pay principal and or interest payments on the notes in same-day funds directly to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit direct participants' accounts on the applicable payment date in accordance with their respective holdings shown on DTC's records upon DTC's receipt of funds and corresponding
detail information. Payments by participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of these participants and not of DTC or any other party, subject to any statutory or regulatory requirements that may be in effect from time to time. Payment of principal and interest to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC, is our responsibility, disbursement of such payments to direct participants is the responsibility of DTC, and disbursement of such payments to the beneficial owners is the responsibility of the direct or indirect participant.

We will send any redemption notices to DTC. If less than all of the notes are being redeemed, DTC's practice is to determine by lot the amount of the interest of each direct participant in such issue to be redeemed.

A beneficial owner, or its authorized representative, shall give notice to elect to have its notes repaid by us, through its direct or indirect participant, to the trustee, and shall effect delivery of such notes by causing the direct participant to transfer that participant's interest in the global note representing such notes, on DTC's records, to the trustee. The requirement for physical delivery of notes in connection with a demand for repayment will be deemed satisfied when the ownership rights in the global note representing such notes are transferred by the direct participants on DTC's records.

DTC may discontinue providing its services as securities depository for the notes at any time by giving us reasonable notice. Under such circumstances, if a successor securities depositary is not obtained, we will print and deliver certificated notes. We may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depositary). In that event, we will print and deliver certificated notes.

The information in this section concerning DTC and DTC's system has been obtained from sources that we believe to be reliable, but neither we, the Purchasing Agent nor any agent takes any responsibility for its accuracy.

Registration, Transfer and Payment of Certificated Notes

If we ever issue notes in certificated form, those notes may be presented for registration, transfer and payment at the office of the registrar or at the office of any transfer agent designated and maintained by us. We have originally designated

American Stock Transfer & Trust Company, LLC to act in those capacities for the notes. The registrar or transfer agent will make the transfer or registration only if it is satisfied with the documents of title and identity of the person making the request. There will not be a service charge for any exchange or registration of transfer of the notes, but we may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with the exchange. At any time, we may change transfer agents or approve a change in the location through which any transfer agent acts. We also may designate additional transfer agents for any notes at any time.

We will not be required to: (1) issue, exchange or register the transfer of any note to be redeemed for a period of 15 days after the selection of the notes to be redeemed; (2) exchange or register the transfer of any note that was selected, called or is being called for redemption, except the unredeemed portion of any note being redeemed in part; or (3) exchange or register the transfer of any note as to which an election for repayment by the holder has been made, except the unrepaid portion of any note being repaid in part.

We will pay principal of and interest on any certificated notes at the offices of the paying agents we may designate from time to time. Generally, we will pay interest on a note by check on any interest payment date other than at stated maturity or upon earlier redemption or repayment to the person in whose name the note is registered at the close of business on the regular record date for that payment. We will pay principal and interest at stated maturity or upon earlier redemption or repayment in same-day funds against presentation and surrender of the applicable notes.

SUPPLEMENT TO MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following summary of U.S. federal income tax considerations supplements the discussion set forth under the heading “Material U.S. Federal Income Tax Considerations” in the accompanying prospectus and is subject to the qualifications and assumptions set forth therein.

The following is a general summary of U.S. federal income tax considerations generally applicable to the purchase, ownership and disposition of the notes. This discussion is based upon the Code, Treasury Regulations and judicial decisions and administrative interpretations thereof, all as of the date hereof and all of which are subject to change or differing interpretations, possibly with retroactive effect. No ruling from the Internal Revenue Service (“IRS”) has been or will be sought regarding any matter discussed herein. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax aspects set forth below.

This discussion applies only to a holder of notes that acquires the notes pursuant to this offering at their “issue price” within the meaning of the applicable provisions of the Code and who holds the notes as a capital asset (generally, property held for investment) under the Code. This discussion does not address any U.S. federal estate or gift tax consequences or any state, local or non-U.S. tax consequences. In addition, this discussion does not address all aspects of U.S. federal income taxation that may be applicable to investors in light of their particular circumstances, or to investors subject to special treatment under U.S. federal income tax law, including, but not limited to:

- banks, insurance companies or other financial institutions;
- pension plans or trusts;
- U.S. noteholders (as defined below) whose functional currency is not the U.S. dollar;
- real estate investment trusts;
- regulated investment companies;
- persons subject to the alternative minimum tax;
- cooperatives;
- tax-exempt organizations;
- dealers in securities;
- expatriates;
- foreign persons or entities (except to the extent set forth below);
- persons deemed to sell the notes under the constructive sale provisions of the Code; or
- persons that hold the notes as part of a straddle, hedge, conversion transaction or other integrated investment.

If a partnership (including any entity or arrangement treated as a partnership for U.S. federal income tax purposes) owns notes, the tax treatment of a partner in the partnership will depend upon the status of the partner and the activities of the partnership. Partners in a partnership that owns the notes should consult their tax advisors as to the particular U.S. federal income tax consequences applicable to them.

We encourage investors to consult their tax advisors regarding the specific consequences of an investment in our notes, including tax reporting requirements, the applicability of U.S. federal, state or local and foreign tax laws, eligibility for the benefits of any applicable tax treaty and the effect of any possible changes in the tax laws.

Consequences to U.S. Noteholders

The following is a general summary of U.S. federal income tax consequences generally applicable to you if you are a U.S. noteholder. U.S. federal income tax consequences generally applicable to non-U.S. noteholders are described under “Consequences to Non-U.S. Noteholders” below. For purposes of this summary, the term “U.S. noteholder” means a beneficial owner of a note that is, for U.S. federal income tax purposes (i) an individual who is a citizen or resident of the U.S., (ii) a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, that is created or organized under the laws of the U.S., any of the States or the District of Columbia, (iii) an estate the income of which is subject to U.S. federal income taxation regardless of its source, or (iv) a trust (A) if a court within the U.S. is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all substantial decisions of such trust, or (B) that has made a valid election to be treated as a U.S. person for U.S. federal income tax purposes.

Stated interest and OID on the notes

Except as discussed below, a U.S. noteholder generally will be required to recognize stated interest as ordinary income at the time it is paid or accrued on the notes in accordance with its regular method of accounting for U.S.

federal income tax purposes. In addition, if the notes' "issue price" (the first price at which a substantial amount of the notes is sold to investors) is less than their "stated redemption price at maturity" (the sum of all payments to be made on the notes other than "qualified stated interest") by more than a statutorily defined de minimis threshold, the notes will be issued with original issue discount

("OID") for U.S. federal income tax purposes. The term "qualified stated interest" generally means stated interest that is unconditionally payable at least annually at a single fixed rate or, if certain requirements are met (as described below), certain variable rates.

If the notes are issued with OID, a U.S. noteholder generally will be required to include the OID in gross income as ordinary interest income in advance of the receipt of cash attributable to that income and regardless of such holder's regular method of tax accounting. Such OID will be included in gross income for each day during each taxable year in which the note is held using a constant yield-to-maturity method that reflects the compounding of interest. This means that the holder will have to include in income increasingly greater amounts of OID over time. Notice will be given in the applicable pricing supplement if we determine that a particular note will be issued with OID. We are required to provide information returns stating the amount of OID accrued on the notes held by persons of record other than certain exempt holders.

If the notes are "step-up notes" (i.e., notes with a fixed interest rate that increases at pre-determined intervals), the tax treatment described in the first sentence under "—Consequences to U.S. Noteholders—Stated interest and OID on the notes" assumes that we will have the right to call the notes at par (plus accrued but unpaid interest) on each date that the interest rate increases. If this is not the case, interest that exceeds the lowest rate payable under the step-up note may not be treated as qualified stated interest and, depending on the amount of such excess, may thus cause the step-up note to be treated as issued with OID, in which case the notes generally would be subject to the OID rules discussed above. Prospective investors are urged to consult their own tax advisors regarding the treatment of step-up notes or similar notes.

If you own a note issued with de minimis OID (i.e., discount that is not OID), you generally must include the de minimis OID in income at the time principal payments on the notes are made in proportion to the amount paid. Any amount of de minimis OID that you have included in income will be treated as capital gain.

Short-term notes

Notes that have a fixed maturity of one year or less ("short-term notes") will be subject to the following special rules. All of the interest on a short-term note is treated as part of the short-term note's stated redemption price at maturity, thereby giving rise to OID. Thus, all short-term notes will be OID debt securities. OID will be treated as accruing on a short-term debt instrument ratably or, at the election of a U.S. noteholder, under a constant yield method.

A U.S. noteholder that uses the cash method of tax accounting (with certain exceptions) will generally not be required to include OID in respect of the short-term note in income on a current basis, though they may be required to include stated interest in income as the income is received. Such a U.S. noteholder may not be allowed to deduct all of the interest paid or accrued on any indebtedness incurred or maintained to purchase or carry such a short-term note until the maturity of the note or its earlier disposition in a taxable transaction. In addition, such a U.S. noteholder will be required to treat any gain realized on a disposition of the note as ordinary income to the extent of the holder's accrued OID on the note, and short-term capital gain to the extent the gain exceeds accrued OID. A U.S. noteholder that uses the cash method of tax accounting may, however, elect to include OID on a short-term note in income on a current basis. In such case, the limitation on the deductibility of interest described above will not apply. A U.S. noteholder that uses the accrual method of tax accounting and certain cash method holders generally will be required to include OID on a short-term note in income on a current basis.

Floating rate notes

In the case of a note that is a floating rate note (including a note based on LIBOR), special rules apply. In general, if a note qualifies for treatment as a "variable rate debt instrument" under Treasury Regulations and provides for stated interest that is unconditionally payable at least annually at a variable rate that, subject to certain exceptions, is a single "qualified floating rate" or "objective rate," each as defined below, all stated interest on the note is treated as qualified stated interest. In that case, both the note's "yield to maturity" and "qualified stated interest" will be determined, for purposes of calculating the accrual of OID, if any, as though the note will bear interest in all periods throughout its term at a fixed rate generally equal to the rate that would be applicable to interest payments on the note on its issue date or, in the case of an objective rate (other than a "qualified inverse floating rate"), the rate that reflects the yield to maturity that is reasonably expected for the note. A U.S. noteholder of a variable rate debt instrument would then recognize OID, if any, that is calculated based on the note's assumed yield to maturity. If the interest actually accrued or paid during an accrual period exceeds or is less than the assumed fixed interest, the qualified stated interest allocable to that period is increased or decreased under rules set forth in Treasury Regulations. Special rules apply for determining the amount of OID for other variable rate debt instruments, such as instruments with more than one qualified floating rate or instruments with a single fixed rate and one or more qualified floating rates. U.S. noteholders should consult their own tax advisors with respect to the specific U.S. federal income tax considerations regarding any investment in a note that qualifies a “variable rate debt instrument.”

A note will generally qualify as a variable rate debt instrument if (a) the note's issue price does not exceed the total noncontingent principal payments by more than the lesser of: (i) .015 multiplied by the product of the total noncontingent principal payments and the number of complete years to maturity from the issue date, or (ii) 15% of the total noncontingent principal payments; (b) the note provides for stated interest, compounded or paid at least annually, only at one or more qualified floating rates, a single fixed rate and one or more qualified floating rates, a single objective rate, or a single fixed rate and a single objective rate that is a qualified inverse floating rate; and (c) the value of the rate on any date during the term of the note is set no earlier than three months prior to the first day on which that value is in effect or no later than one year following that first day.

Generally, a rate is a qualified floating rate if variations in the rate can reasonably be expected to measure contemporaneous fluctuations in the cost of newly borrowed funds in the currency in which the debt instrument is denominated. A rate that equals LIBOR or LIBOR plus or minus a fixed spread is, in general, a qualified floating rate. However, a rate (including a rate based on LIBOR) will generally not be a qualified floating rate if, among other circumstances:

- the rate is subject to one or more minimum or maximum rate floors or ceilings or one or more governors limiting the amount of increase or decrease in each case which are not fixed throughout the term of the note and which are reasonably expected as of the issue date to cause the rate in some accrual periods to be significantly higher or lower than the overall expected return on the note determined without the floor, ceiling, or governor; or
- the rate is a multiple of a qualified floating rate unless the multiple is a fixed multiple that is greater than 0.65 but not more than 1.35 (provided, however, that if a multiple of a qualified floating rate is not within such limits and thus is not itself a qualified floating rate, it may nevertheless qualify as an "objective rate").

If a note provides for two or more qualified floating rates that are within 0.25 percentage points of each other on the issue date or can reasonably be expected to have approximately the same values throughout the term of the note, the qualified floating rates together constitute a single qualified floating rate.

Generally, an objective rate is a rate that is determined using a single fixed formula that is based on objective financial or economic information such as one or more qualified floating rates. An objective rate is a qualified inverse floating rate if that rate is equal to a fixed rate minus a qualified floating rate and variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the qualified floating rate. A variable rate will generally not qualify as an objective rate if, among other circumstances, it is reasonably expected that the average value of the variable rate during the first half of the term of the note will be either significantly less than or significantly greater than the average value of the rate during the final half of the term of the note.

If a floating rate note does not qualify as a "variable rate debt instrument," the note generally will be subject to taxation under special rules applicable to contingent payment debt instruments. U.S. noteholders should consult their own tax advisors with respect to the specific U.S. federal income tax considerations regarding such notes.

Sale, exchange, redemption or other taxable disposition of the notes

Subject to the special rules for short-term notes discussed above, upon the sale, exchange, redemption or other taxable disposition of a note, a U.S. noteholder generally will recognize capital gain or loss in an amount equal to the difference between (1) the sum of cash plus the fair market value of all other property received on such disposition (except to the extent such cash or property is attributable to accrued but unpaid interest, which, to the extent not previously included in income, generally will be taxable as ordinary income) and (2) its adjusted tax basis in the note. A U.S. noteholder's adjusted tax basis in a note generally will equal the price the U.S. noteholder paid for the note increased by OID (including with respect to a short-term note), if any, previously included in income with respect to that note, and reduced by any cash payments on the note other than qualified stated interest. Such capital gain or loss will be long-term capital gain or loss if, at the time of such taxable disposition, the U.S. noteholder has held the note for more than one year. The deductibility of capital losses is subject to limitations.

Medicare tax

Certain U.S. noteholders who are individuals, estates or trusts and whose income exceeds certain thresholds will be required to pay a 3.8% Medicare tax on all or a portion of their "net investment income," which includes interest on the notes and capital gains from the sale or other disposition of the notes.

Information reporting and backup withholding

In general, information reporting requirements will apply to certain payments of principal and interest (including OID) and to the proceeds of sale of a note paid to a U.S. noteholder (unless such noteholder is an exempt recipient). A backup withholding tax may apply to such payments if a U.S. noteholder fails to provide a taxpayer identification number or certification of exempt status, or if it is otherwise subject to backup withholding.

Any amounts withheld under the backup withholding rules will be allowed as a refund or credit against a U.S. noteholder's United States federal income tax liability provided the required information is timely furnished to the IRS.

Consequences to Non-U.S. Noteholders

The following is a general summary of U.S. federal income tax consequences generally applicable to you if you are a non-U.S. noteholder. A beneficial owner of a note that is not a partnership for U.S. federal income tax purposes (including any entity or arrangement otherwise treated as a partnership for U.S. federal income tax purposes) or a U.S. noteholder is referred to herein as a "non-U.S. noteholder."

Stated interest and OID on the notes

Stated interest and OID, if any, paid or accrued to a non-U.S. noteholder will generally not be subject to U.S. federal income or withholding tax if the interest or OID is not effectively connected with its conduct of a trade or business within the United States and is not considered contingent interest within the meaning of Section 871(h)(4)(A) of the Code (generally relating to interest payments that are determined by reference to the income, profits, receipts, cash flow, changes in the value of non-publicly-traded property or other attributes of, or distributions or similar payments paid by, the debtor or a related party), and the non-U.S. noteholder:

- does not own, actually or constructively, 10% or more of the total combined voting power of all classes of our stock entitled to vote;
- is not a "controlled foreign corporation" with respect to which we are, directly or indirectly, a "related person";
- is not a bank whose receipt of interest on the notes is described in section 881(c)(3)(A) of the Code; and
- provides its name and address, and certifies, under penalties of perjury, that it is not a U.S. person (on a properly executed IRS Form W-8BEN or W-8BEN-E (or other applicable form)), or holds its notes through certain foreign intermediaries and satisfies the certification requirements of applicable Treasury Regulations.

If a non-U.S. noteholder does not qualify for an exemption under these rules, interest income and OID, if any, from the notes may be subject to withholding tax at the rate of 30% (or lower applicable treaty rate). Stated interest and OID, if any, effectively connected with a non-U.S. noteholder's conduct of a U.S. trade or business (and, if required by an applicable income tax treaty, which is attributable to a United States permanent establishment), however, would not be subject to a 30% withholding tax so long as the non-U.S. noteholder provides us or our paying agent an adequate certification (currently on IRS Form W-8ECI); such payments of interest generally would be subject to U.S. federal income tax on a net basis at the rates applicable to U.S. persons generally. In addition, if a non-U.S. noteholder is a foreign corporation and the stated interest and OID, if any, is effectively connected with its conduct of a U.S. trade or business, it may also be subject to a 30% (or lower applicable treaty rate) branch profits tax on its effectively connected earnings and profits for the taxable year, subject to adjustments. To claim the benefit of a tax treaty, a non-U.S. noteholder must provide a properly executed IRS Form W-8BEN or W-8BEN-E (or other applicable form) to us or our paying agent before the payment of stated interest or OID, and may be required to obtain a U.S. taxpayer identification number and provide documentary evidence issued by foreign governmental authorities to prove residence in the foreign country.

Sale, exchange, redemption or other taxable disposition of the notes

Any gain recognized by a non-U.S. noteholder on the sale, exchange, redemption or other taxable disposition of the notes (except with respect to accrued and unpaid interest, which would be taxed as described under "Consequences to Non-U.S. Noteholders—Stated interest and OID on the notes" above) generally will not be subject to U.S. federal income tax unless:

- the gain is effectively connected with its conduct of a U.S. trade or business (and, if required by an applicable income tax treaty, is attributable to a United States permanent establishment); or
- the non-U.S. noteholder is a nonresident alien individual present in the U.S. for 183 or more days in the taxable year within which the sale, exchange, redemption or other disposition takes place and certain other requirements are met.

If a non-U.S. noteholder is a holder described in the first bullet point above, the net gain derived from the sale, exchange, redemption or other taxable disposition of its notes generally will be subject to U.S. federal income tax on a net basis at the rates applicable to U.S. persons generally. In addition, if such non-U.S. noteholder is a foreign corporation, it may also be subject to a 30% (or lower applicable treaty rate) branch profits tax on its effectively connected earnings and profits for the taxable year, subject to adjustments. If a non-U.S. noteholder is a holder described in the second bullet point above, it will be subject to a flat 30% U.S. federal income tax on the gain derived from the sale, exchange, redemption or other taxable disposition of its notes, which may be offset by U.S. source capital losses, even though it is not considered a resident of the United States.

Information Reporting and Backup Withholding

Generally, we must report to the IRS and to a non-U.S. noteholder the amount of interest (including OID) on the notes paid to a non-U.S. noteholder and the amount of tax, if any, withheld with respect to those payments if the notes are in registered form. Copies of the information returns reporting such interest payments and any withholding may also be made available to the tax authorities in the country in which a non-U.S. noteholder resides under the provisions of an applicable income tax treaty.

In general, a non-U.S. noteholder will not be subject to backup withholding with respect to payments on the notes that we make to such noteholder provided that we do not have actual knowledge or reason to know that such noteholder is a U.S. person as defined under the Code, and we have received from you the statement described above under the fourth bullet point under "Consequences to Non-U.S. Noteholders—Stated interest and OID on the notes."

In addition, no information reporting requirements or backup withholding will be required regarding the proceeds of the sale of a note made within the United States or conducted through certain United States-related financial intermediaries, if the payor receives the statement described above and does not have actual knowledge or reason to know that the non-U.S. noteholder is a U.S. person as defined under the Code, or the non-U.S. noteholder otherwise establishes an exemption.

Any amounts withheld under the backup withholding rules will be allowed as a refund or credit against a non-U.S. noteholder's United States federal income tax liability provided the required information is timely furnished to the IRS.

Other withholding rules

Withholding at a rate of 30% will be required on interest in respect of, and after December 31, 2018, on gross proceeds from the sale of, notes held by or through certain foreign financial institutions (including investment funds), unless such institution enters into an agreement with the Secretary of the Treasury to report, on an annual basis, information with respect to shares in, and accounts maintained by, the institution to the extent such shares or accounts are held by certain United States persons or by certain non-U.S. entities that are wholly or partially owned by United States persons and to withhold on certain payments. Accordingly, the entity through which notes are held will affect the determination of whether such withholding is required. An intergovernmental agreement between the United States and an applicable foreign country, or future guidance, may modify these requirements. Similarly, interest in respect of, and after December 31, 2018, gross proceeds from the sale of, notes held by an investor that is a non-financial non-U.S. entity will be subject to withholding at a rate of 30%, unless such entity either (i) certifies to us that such entity does not have any "substantial United States owners" or (ii) provides certain information regarding the entity's "substantial United States owners," which we will in turn provide to the Secretary of the Treasury. Non-U.S. noteholders are encouraged to consult with their tax advisors regarding the possible implications of these requirements on their investment in notes.

Non-U.S. noteholders should consult any applicable income tax treaties that may provide for different rules. In addition, non-U.S. noteholders are urged to consult their tax advisors regarding the tax consequences of the purchase, ownership and disposition of the notes.

CERTAIN CONSIDERATIONS APPLICABLE TO ERISA, GOVERNMENTAL AND OTHER PLAN INVESTORS

A fiduciary of a pension plan or other employee benefit plan (including a governmental plan, an individual retirement account or a Keogh plan) proposing to invest in the notes should consider this section carefully.

A fiduciary of an employee benefit plan subject to the Employee Retirement Income Security Act of 1974, as amended (commonly referred to as "ERISA"), should consider fiduciary standards under ERISA in the context of the particular circumstances of such plan before authorizing an investment in the notes. Such fiduciary should consider whether the investment is in accordance with the documents and instruments governing the plan.

In addition, ERISA and the Code prohibit certain transactions (referred to as "prohibited transactions") involving the assets of a plan subject to ERISA or the assets of an individual retirement account or plan subject to Section 4975 of the Code (referred to as an "ERISA plan"), on the one hand, and persons who have certain specified relationships to the plan ("parties in interest" within the meaning of ERISA or "disqualified persons" within the meaning of the Code), on the other. If we (or an affiliate) are considered a party in interest or disqualified person with respect to an ERISA plan, then the investment in notes by the ERISA plan may give rise to a prohibited transaction. The purchase and holding of notes by an ERISA plan may be subject to one or more statutory or administrative exemptions from the prohibited transaction rules under ERISA and the Code. Even if the conditions for relief under such exemptions were satisfied, however, there can be no assurance that such exemptions would apply to all of the prohibited transactions that may be deemed to arise in connection with a plan's investment in the notes.

By purchasing and holding the notes, the person making the decision to invest on behalf of an ERISA plan is representing that the purchase and holding of the notes will not result in a prohibited transaction under ERISA or the Code. Therefore, an ERISA plan should not invest in the notes unless the plan fiduciary or other person acquiring securities on behalf of the ERISA plan determines that neither we nor an affiliate is a party in interest or a disqualified person or, alternatively, that an exemption from the prohibited transaction rules is available. If an ERISA plan engages in a prohibited transaction, the transaction may require "correction" and may cause the ERISA plan fiduciary to incur certain liabilities and the parties in interest or disqualified persons to be subject to excise taxes.

Employee benefit plans that are governmental plans and non-U.S. plans, and certain church plans, are not subject to ERISA requirements. However, non-U.S., federal, state or local laws or regulations governing the investment and management of the assets of such plans may contain fiduciary and prohibited transaction requirements similar to those under ERISA and Section 4975 of the Code discussed above. By purchasing and holding the notes, the person making the decision to invest on behalf of any such plan is representing that the purchase and holding of the notes will not violate any law applicable to such plan that is similar to the prohibited transaction provisions of ERISA or the Code.

If you are the fiduciary of an employee benefit plan, whether or not subject to ERISA, and you propose to invest in the notes with the assets of such employee benefit plan, you should consult your own legal counsel for further guidance.

The sale of notes to an employee benefit plan is in no respect a representation by us, the Purchasing Agent or any other person that such an investment meets all relevant legal requirements with respect to investments by employee benefit plans generally or any particular plan or that such an investment is appropriate for employee benefit plans generally or any particular plan.

USE OF PROCEEDS

Unless otherwise indicated in a pricing supplement for the notes, we expect to use the net proceeds from the sale of the notes initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, if any, and redemption of outstanding Prospect Capital InterNotes® and other debt, investments in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objective. We anticipate that substantially all of the net proceeds from each offering will be used for the above purposes within six months, depending on the availability of appropriate investment opportunities consistent with our investment objective and market conditions.

As of November 10, 2016, our credit facility is undrawn, and based on the assets currently pledged as collateral on the facility, a total of approximately $593.8 million was available to us for borrowing under our credit facility including outstanding borrowings. Interest on borrowings under the credit facility is one-month LIBOR plus 225 basis points, with no minimum LIBOR floor. Additionally, the lenders charge a fee on the unused portion of the credit facility equal to either 50 basis points if at least 35% of the credit facility is used or 100 basis points otherwise.

SENIOR SECURITIES

Information about our senior securities is shown in the following table as of each fiscal year ended June 30 since the Company commenced operations and as of September 30, 2016. (All figures in this item are in thousands except per unit data.)

	Total Amount Outstanding(1)	Asset Coverage per Unit(2)	Involuntary Liquidating Preference per Unit(3)	Average Market Value per Unit(4)
Credit Facility				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 44,000	$138,549	—	—
Fiscal 2016 (as of June 30, 2016)	—	—	—	—
Fiscal 2015 (as of June 30, 2015)	368,700	18,136	—	—
Fiscal 2014 (as of June 30, 2014)	92,000	69,470	—	—
Fiscal 2013 (as of June 30, 2013)	124,000	34,996	—	—
Fiscal 2012 (as of June 30, 2012)	96,000	22,668	—	—
Fiscal 2011 (as of June 30, 2011)	84,200	18,065	—	—
Fiscal 2010 (as of June 30, 2010)	100,300	8,093	—	—
Fiscal 2009 (as of June 30, 2009)	124,800	5,268	—	—
Fiscal 2008 (as of June 30, 2008)	91,167	5,712	—	—
Fiscal 2007 (as of June 30, 2007)	—	N/A	—	—
2015 Notes(5)				
Fiscal 2015 (as of June 30, 2015)	$ 150,000	$44,579	—	—
Fiscal 2014 (as of June 30, 2014)	150,000	42,608	—	—
Fiscal 2013 (as of June 30, 2013)	150,000	28,930	—	—
Fiscal 2012 (as of June 30, 2012)	150,000	14,507	—	—
Fiscal 2011 (as of June 30, 2011)	150,000	10,140	—	—
2016 Notes(6)				
Fiscal 2016 (as of June 30, 2016)	$ 167,500	$36,677	—	—
Fiscal 2015 (as of June 30, 2015)	167,500	39,921	—	—
Fiscal 2014 (as of June 30, 2014)	167,500	38,157	—	—
Fiscal 2013 (as of June 30, 2013)	167,500	25,907	—	—
Fiscal 2012 (as of June 30, 2012)	167,500	12,992	—	—
Fiscal 2011 (as of June 30, 2011)	172,500	8,818	—	—
2017 Notes				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 129,500	$47,074	—	—
Fiscal 2016 (as of June 30, 2016)	129,500	47,439	—	—
Fiscal 2015 (as of June 30, 2015)	130,000	51,437	—	—
Fiscal 2014 (as of June 30, 2014)	130,000	49,163	—	—
Fiscal 2013 (as of June 30, 2013)	130,000	33,381	—	—
Fiscal 2012 (as of June 30, 2012)	130,000	16,739	—	—
2018 Notes				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 200,000	$30,481	—	—
Fiscal 2016 (as of June 30, 2016)	200,000	30,717	—	—
Fiscal 2015 (as of June 30, 2015)	200,000	33,434	—	—
Fiscal 2014 (as of June 30, 2014)	200,000	31,956	—	—

Fiscal 2013 (as of June 30, 2013)	200,000	21,697	—	—

	Total Amount Outstanding(1)	Asset Coverage per Unit(2)	Involuntary Liquidating Preference per Unit(3)	Average Market Value per Unit(4)
2019 Notes				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 200,000	$ 30,481	—	—
Fiscal 2016 (as of June 30, 2016)	200,000	30,717	—	—
Fiscal 2015 (as of June 30, 2015)	200,000	33,434	—	—
Fiscal 2014 (as of June 30, 2014)	200,000	31,956	—	—
Fiscal 2013 (as of June 30, 2013)	200,000	21,697	—	—
5.00% 2019 Notes				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 300,000	$ 20,320	—	—
Fiscal 2016 (as of June 30, 2016)	300,000	20,478	—	—
Fiscal 2015 (as of June 30, 2015)	300,000	22,289	—	—
Fiscal 2014 (as of June 30, 2014)	300,000	21,304	—	—
2020 Notes				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 392,000	$ 15,551	—	—
Fiscal 2016 (as of June 30, 2016)	392,000	15,672	—	—
Fiscal 2015 (as of June 30, 2015)	392,000	17,058	—	—
Fiscal 2014 (as of June 30, 2014)	400,000	15,978	—	—
2022 Notes(7)				
Fiscal 2014 (as of June 30, 2014)	$ 100,000	$ 63,912	—	$ 1,038
Fiscal 2013 (as of June 30, 2013)	100,000	43,395	—	1,036
Fiscal 2012 (as of June 30, 2012)	100,000	21,761	—	996
2023 Notes(9)				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 250,000	$ 24,385	—	—
Fiscal 2016 (as of June 30, 2016)	248,293	24,742	—	—
Fiscal 2015 (as of June 30, 2015)	248,094	26,953	—	—
Fiscal 2014 (as of June 30, 2014)	247,881	25,783	—	—
Fiscal 2013 (as of June 30, 2013)	247,725	17,517	—	—
2024 Notes				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 199,281	$ 30,591	—	$ 1,025
Fiscal 2016 (as of June 30, 2016)	161,364	38,072	—	951
Prospect Capital InterNotes®				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 945,746	$ 6,446	—	—
Fiscal 2016 (as of June 30, 2016)	908,808	6,760	—	—
Fiscal 2015 (as of June 30, 2015)	827,442	8,081	—	—
Fiscal 2014 (as of June 30, 2014)	785,670	8,135	—	—
Fiscal 2013 (as of June 30, 2013)	363,777	11,929	—	—
Fiscal 2012 (as of June 30, 2012)	20,638	105,442	—	—
All Senior Securities(8)				
Fiscal 2017 (as of September 30, 2016, unaudited)	$ 2,660,527	$ 2,291	—	—

Fiscal 2016 (as of June 30, 2016)	2,707,465	2,269	—	—
Fiscal 2015 (as of June 30, 2015)	2,983,736	2,241	—	—
Fiscal 2014 (as of June 30, 2014)	2,773,051	2,305	—	—
Fiscal 2013 (as of June 30, 2013)	1,683,002	2,578	—	—
Fiscal 2012 (as of June 30, 2012)	664,138	3,277	—	—

(1) Total amount of each class of senior securities outstanding at the end of the year/period presented (in 000's).
(2) The asset coverage ratio for a class of senior securities representing indebtedness is calculated as our consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness. This asset coverage ratio is multiplied by $1,000 to determine the Asset Coverage Per Unit.
(3) This column is inapplicable.
(4) This column is inapplicable, except for the 2022 Notes and the 2024 Notes. The average market value per unit is calculated as an average of quarter-end prices and shown as the market value per $1,000 of indebtedness.
(5) We repaid the outstanding principal amount of the 2015 Notes on December 15, 2015.
(6) We repaid the outstanding principal amount of the 2016 Notes on August 15, 2016.
(7) We redeemed the 2022 Notes on May 15, 2015.
(8) While we do not consider commitments to fund under revolving arrangements to be Senior Securities, if we were to elect to treat such unfunded commitments, which were $42,484 as of September 30, 2016, as Senior Securities for purposes of Section 18 of the 1940 Act, our asset coverage per unit would be $2,271.
(9) For all fiscal years ended June 30th, the notes are presented net of unamortized discount.

RATIO OF EARNINGS TO FIXED CHARGES

For the three months ended September 30, 2016 and the years ended June 30, 2016, 2015, 2014, 2013 and 2012, the ratios of earnings to fixed charges of the Company, computed as set forth below, were as follows:

	For the three months ended September 30, 2016	For the Year Ended June 30, 2016	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012
Earnings to Fixed Charges(1)	2.95	1.63	3.04	3.45	3.89	5.95

For purposes of computing the ratios of earnings to fixed charges, earnings represent net increase in net assets resulting from operations plus (or minus) income tax expense including excise tax expense plus fixed charges. Fixed charges include interest and credit facility fees expense and amortization of debt issuance costs.

(1) Earnings include the net change in unrealized appreciation or depreciation. Net change in unrealized appreciation or depreciation can vary substantially from year to year. Excluding the net change in unrealized appreciation or depreciation, the earnings to fixed charges ratio would be 2.91 for the three months ended September 30, 2016, 3.08 for the year ended June 30, 2016, 2.06 for the year ended June 30, 2015, 3.72 for the year ended June 30, 2014, 4.91 for the year ended June 30, 2013, and 6.79 for the year ended June 30, 2012.

PLAN OF DISTRIBUTION

Under the terms of the Sixth Amended and Restated Selling Agent Agreement dated November 10, 2016, which we refer to as the "Selling Agent Agreement," the notes will be offered from time to time by us to the Purchasing Agent for subsequent resale to agents, including Citigroup Global Markets Inc. and RBC Capital Markets, LLC and other dealers who are broker-dealers and securities firms. The agents, including the Purchasing Agent, and the additional agents named from time to time pursuant to the Selling Agent Agreement, are, or will be, parties to the Selling Agent Agreement. The notes will be offered for sale in the United States only. Dealers who are members of the selling group have executed a Master Selected Dealer Agreement with the Purchasing Agent. We also may appoint additional agents to sell the notes. Any sale of the notes through those additional agents, however, will be on the same terms and conditions to which the original agents have agreed. The Purchasing Agent will purchase the notes at a discount ranging from 0.4% to 3.8% of the non-discounted price for each note sold. However, we also may sell the notes to the Purchasing Agent at a discount greater than or less than the range specified above. The discount at which we sell the notes to the Purchasing Agent will be set forth in the applicable pricing supplement. The Purchasing Agent also may sell notes to dealers at a concession not in excess of the discount it received from us. In certain cases, the Purchasing Agent and the other agents and dealers may agree that the Purchasing Agent will retain the entire discount. We will disclose any particular arrangements in the applicable pricing supplement.

Following the solicitation of orders, each of the agents, severally and not jointly, may purchase notes as principal for its own account from the Purchasing Agent. Unless otherwise set forth in the applicable pricing supplement, these notes will be purchased by the agents and resold by them to one or more investors at a fixed public offering price. After the initial public offering of notes, the public offering price (in the case of notes to be resold at a fixed public offering price), discount and concession may be changed.

We have the sole right to accept offers to purchase notes and may reject any proposed offer to purchase notes in whole or in part. Each agent also has the right, in its discretion reasonably exercised, to reject any proposed offer to purchase notes in whole or in part. We reserve the right to withdraw, cancel or modify any offer without notice. We also may change the terms, including the interest rate we will pay on the notes, at any time prior to our acceptance of an offer to purchase.

Each agent, including the Purchasing Agent, may be deemed to be an "underwriter" within the meaning of the Securities Act. We have agreed to indemnify the agents against certain liabilities, including liabilities under the Securities Act, or to contribute to any payments they may be required to make in respect of such liabilities. We also have agreed to reimburse the agents for certain expenses.

No note will have an established trading market when issued. We do not intend to apply for the listing of the notes on any securities exchange. However, we have been advised by the agents that they may purchase and sell notes in the secondary market as permitted by applicable laws and regulations. The agents are not obligated to make a market in the notes, and they may discontinue making a market in the notes at any time without notice. Neither we nor the agents can provide any assurance regarding the development, liquidity or maintenance of any trading market for any notes. All secondary trading in the notes will settle in same-day funds. See "Registration and Settlement."

In connection with certain offerings of notes, the rules of the SEC permit the Purchasing Agent to engage in transactions that may stabilize the price of the notes. The Purchasing Agent will conduct these activities for the agents. These transactions may consist of short sales, stabilizing transactions and purchases to cover positions created by short sales. A short sale is the sale by the Purchasing Agent of a greater amount of notes than the amount the Purchasing Agent has agreed to purchase in connection with a specific offering of notes. Stabilizing transactions consist of certain bids or purchases made by the Purchasing Agent to prevent or retard a decline in the price of the notes while an offering of notes is in process. In general, these purchases or bids for the notes for the purpose of stabilization or to reduce a syndicate short position could cause the price of the notes to be higher than it might otherwise be in the absence of those purchases or bids. Neither we nor the Purchasing Agent makes any representation or prediction as to the direction or magnitude of any effect that these transactions may have on the price of any notes. In addition, neither we nor the Purchasing Agent makes any representation that, once commenced, these transactions will not be discontinued without notice. The Purchasing Agent is not required to engage in these activities and may end any of these activities at any time.

Some of the agents and their affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with us or our affiliates. They have received, or may in the future receive, customary fees and commissions for these transactions.

In addition, in the ordinary course of their business activities, the agents and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of ours or our affiliates. The agents and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

DIVIDEND REINVESTMENT AND DIRECT STOCK PURCHASE PLAN

We have adopted a dividend reinvestment and direct stock purchase plan that provides for reinvestment of our dividends or distributions on behalf of our stockholders, unless a stockholder elects to receive cash as provided below, and the ability to purchase additional shares by making optional cash investments. As a result, when our Board of Directors authorizes, and we declare, a cash dividend or distribution, then our stockholders who have not "opted out" of our dividend reinvestment and direct stock purchase plan will have their cash dividends or distributions automatically reinvested in additional shares of our common stock, rather than receiving the cash dividends or distributions. If you are not a current stockholder and want to enroll or have "opted out" and wish to rejoin, you may purchase shares directly through the plan or opt in by enrolling online or submitting to the plan administrator a completed enrollment form and, if you are not a current stockholder, making an initial investment of at least $250.

No action is required on the part of a registered stockholder to have their cash dividend or distribution reinvested in shares of our common stock. A registered stockholder may elect to receive an entire dividend or distribution in cash by notifying the plan administrator and our transfer agent and registrar, in writing so that such notice is received by the plan administrator no later than the record date for dividends to stockholders. The plan administrator will set up a dividend reinvestment account for shares acquired pursuant to the plan for each stockholder who has not so elected to receive dividends and distributions in cash or who has enrolled in the plan as described herein (each, a "Participant"). The plan administrator will hold each Participant's shares, together with the shares of other Participants, in non-certificated form in the plan administrator's name or that of its nominee. Upon request by a Participant to terminate their participation in the plan, received in writing, via the internet or the plan administrator's toll free number no later than 3 business days prior to a dividend or distribution payment date, such dividend or distribution will be paid out in cash and not be reinvested. If such request is received fewer than 3 business days prior to a dividend or distribution payment date, such dividend or distribution will be reinvested but all subsequent dividends and distributions will be paid to the stockholder in cash on all balances. Upon such termination of the Participant's participation in the plan, all whole shares owned by the Participant will be issued to the Participant in certificated form and a check will be issued to the Participant for the proceeds of fractional shares less a transaction fee of $15.00 to be deducted from such proceeds. Those stockholders whose shares are held by a broker or other financial intermediary may receive dividends or distributions in cash by notifying their broker or other financial intermediary of their election.

We primarily use newly-issued shares to implement reinvestment of dividends and distributions under the plan, whether our shares are trading at a premium or at a discount to net asset value. However, we reserve the right to purchase shares in the open market in connection with the implementation of reinvestment of dividends or distributions under the plan. The number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the dividend or distribution payable to such stockholder by the market price per share of our common stock at the close of regular trading on the NASDAQ Global Select Market on the last business day before the payment date for such dividend or distribution. Market price per share on that date will be the closing price for such shares on the NASDAQ Global Select Market or, if no sale is reported for such day, at the average of their reported bid and asked prices. The number of shares of our common stock to be outstanding after giving effect to payment of the dividend or distribution cannot be established until the value per share at which additional shares will be issued has been determined and elections of our stockholders have been tabulated. Stockholders who do not elect to receive dividends and distributions in shares of common stock may experience accretion to the net asset value of their shares if our shares are trading at a premium at the time we issue new shares under the plan and dilution if our shares are trading at a discount. The level of accretion or discount would depend on various factors, including the proportion of our stockholders who participate in the plan, the level of premium or discount at which our shares are trading and the amount of the dividend or distribution payable to a stockholder.

There are no brokerage charges or other charges to stockholders who participate in reinvestment of dividends or distributions under the plan. The plan administrator's fees under the plan are paid by us. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant's account and remit the proceeds to the participant, the plan administrator is authorized to deduct a $15 transaction fee plus a $0.10 per share brokerage commissions from the proceeds.

Stockholders who receive dividends or distributions in the form of stock are subject to the same U.S. federal, state and local tax consequences as are stockholders who elect to receive their dividends or distributions in cash. A stockholder's basis for determining gain or loss upon the sale of stock received in a dividend or distribution from us will be equal to the total dollar amount of the dividend or distribution payable to the stockholder. Any stock received in a dividend or distribution will have a new holding period for tax purposes commencing on the day following the day on which the shares are credited to the U.S. Stockholder's account (as defined below).

Participants in the plan have the option of making additional cash payments to the plan administrator for investment in the shares at the then current market price. Such payments may be made in any amount from $25 to $10,000 per transaction.

Participants in the plan may also elect to have funds electronically withdrawn from their checking or savings account each month. Direct debit of cash will be performed on the 10th of each month. Participants may elect this option by submitting a written authorization form or by enrolling online at the plan administrator's website. The plan administrator will use all funds received from participants since the prior investment of funds to purchase shares of our common stock in the open market. We will not use newly-issued shares of our common stock to implement such purchases. Purchase orders will be submitted daily. The Plan Administrator may, at its discretion, submit purchase orders less frequently but no later than 30 days after receipt. The plan administrator will charge each stockholder who makes such additional cash payments $2.50, plus a $0.10 per share brokerage commission. Cash dividends and distributions payable on all shares credited to your plan account will be automatically reinvested in additional shares pursuant to the terms of the plan. Brokerage charges for such purchases are expected to be less than the usual brokerage charge for such transactions. Instructions sent by a participant to the plan administrator in connection with such participant's cash payment may not be rescinded.

Participants may terminate their accounts under the plan by notifying the plan administrator via its website at www.amstock.com or by filling out the transaction request form located at the bottom of their statement and sending it to the plan administrator at American Stock Transfer & Trust Company, P.O. Box 922, Wall Street Station, New York, NY 10269-0560 or by calling the plan administrator's Interactive Voice Response System at (888) 888-0313. Upon termination, the stockholder will receive certificates for the full shares credited to your plan account. If you elect to receive cash, the plan administrator sells such shares and delivers a check for the proceeds, less the $0.10 per share commission and the plan administrator's transaction fee of $15. In every case of termination, fractional shares credited to a terminating plan account are paid in cash at the then-current market price, less any commission and transaction fee.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any payable date for the payment of any dividend by us or distribution pursuant to any additional cash payment made. All correspondence concerning the plan should be directed to the plan administrator by mail at American Stock Transfer and Trust Company LLC, 6201 15th Avenue, Brooklyn, New York 11219, or by telephone at 888-888-0313.

Stockholders who purchased their shares through or hold their shares in the name of a broker or financial institution should consult with a representative of their broker or financial institution with respect to their participation in our dividend reinvestment plan and direct stock purchase plan. Such holders of our stock may not be identified as our registered stockholders with the plan administrator and may not automatically have their cash dividend or distribution reinvested in shares of our common stock by the plan administrator.

1. How do I purchase shares if I am not an existing registered holder?
To make an investment online, log on to www.amstock.com, click on “Shareholders” followed by “Invest Online,” then select “All Plans” from the left toolbar. Select “Prospect Capital Corporation” Common Stock,” followed by “Invest Now.” Follow the “Steps to Invest,” which will guide you through the six-step investment process. Follow the prompts to provide your banking account number and ABA routing number to allow for the direct debit of funds from your savings or checking account. You will receive a receipt of your transaction upon completion of the investment process, as well as a subsequent e-mail confirming the number of shares purchased and their price (generally within two business days). To invest by mail, complete an Enrollment Application, which can be obtained by calling the Plan Administrator at 1-888-888-0313, and enclose a check made payable to American Stock Transfer & Trust Company, LLC for the value of your investment. The Enrollment Application may also be downloaded from the Plan Administrator’s website (www.amstock.com). The minimum initial investment is $250.00. The maximum investment is $10,000.00 per transaction. Once you are a stockholder, the minimum purchase amount is reduced to $25.00. For purchases made with voluntary contributions, there is a transaction fee of $2.50 per purchase and a per-share commission of $0.10, each to be paid by the participants in the Plan. Your cash payment, less applicable service charges, fees and commissions, will be used to purchase shares on the open market for your account. Both full and fractional shares, up to three decimal places, will be credited to your Plan account. The Plan Administrator will commingle net funds (if applicable) with cash payments from all participants to purchase shares in the open market. Purchase orders will be submitted daily. The Plan Administrator may, at its discretion, submit purchase orders less frequently but no later than 30 days after receipt. No interest will be paid by the Plan Administrator pending investment. Instructions sent to the Plan Administrator may not be rescinded. You may also authorize the Plan Administrator, on the enrollment application or the Plan Administrator’s website, to make monthly purchases of a specified dollar amount, by automatic withdrawal from your bank account. Funds will be withdrawn from your bank account, via electronic funds transfer (EFT), on the 10th day of each month (or the next following day if the 10th is not a business day). To terminate monthly purchases by automatic withdrawal, please send the Plan Administrator written, signed instructions, which must be received by the Plan Administrator not less than 3 business days prior to an automatic withdrawal for such termination to take effect prior to such withdrawal. It is your responsibility to notify the Plan Administrator if your direct debit information changes. If a check or ACH withdrawal is returned to the Plan Administrator as “unpaid,” the Plan Administrator will sell shares if already purchased and liquidate additional shares, if necessary, to reimburse itself for any loss incurred, as well as a returned check fee of $25.00. This is in addition to any other rights the Plan Administrator may have.
Stockholders who purchased their shares through or hold their shares in the name of a broker or financial institution should consult with a representative of their broker or financial institution with respect to their participation in the Plan. Such holders of common stock may not be identified as registered stockholders of Prospect Capital Corporation with the Plan Administrator.
2. How do I purchase additional shares if I am already a registered stockholder?
Additional shares may be purchased at any time. All of the terms outlined in Section #1 above apply, except the minimum investment is only $25.00. To make an investment online, log on to www.amstock.com and select “Shareholders” followed by “Account Access and General Information,” and finally “Account Access.” You will be prompted to enter your Unique Account ID. If you do not have a Unique Account ID, register directly online and your Unique Account ID will be provided. Follow the prompts when registering for your Unique Account ID. From the left toolbar, select “Purchase Additional Shares” and complete the steps. Optional cash payments may also be mailed to the Plan Administrator using the tear-off portion of your account statement (sent in conjunction with each scheduled dividend) or purchase transaction advice, or via detailed written instructions. You may also authorize the Plan Administrator, on an enrollment application or the Plan Administrator’s website, to make monthly purchases of a specified dollar amount by automatic withdrawal from your bank account. Funds will be withdrawn from your bank account, via electronic funds transfer (EFT), on the 10th day of each month (or the next following day if the 10th is not a business day). To terminate monthly purchases by automatic withdrawal, you must send the Plan Administrator written, signed instructions. It is your responsibility to notify the Plan Administrator if your direct debit information changes. All shares will be purchased in the open market at the current market price.

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LEGAL MATTERS

The legality of the notes will be passed upon for the Company by Joseph Ferraro, our General Counsel, Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden, Arps"), New York, New York, and Venable LLP, as special Maryland counsel, Baltimore, Maryland, will pass on certain matters for the Company. Troutman Sanders LLP will pass on certain matters for the agents. Skadden, Arps and Venable LLP each have from time to time acted as counsel for us and our subsidiaries and may do so in the future.

INDEPENDENT ACCOUNTING FIRMS

BDO USA, LLP is the independent registered public accounting firm of the Company and National Property REIT Corp. MSPC is the independent registered public accounting firm of Harbortouch Payments, LLC. Hood & Strong LLP is the independent registered public accounting firm of NPH McDowell, LLC. Tidwell Group, LLC is the independent public accounting firm of Michigan Storage, LLC. RSM US LLP is the independent registered public accounting firm of First Tower Finance Company LLC.

AVAILABLE INFORMATION

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act, with respect to the notes offered by this prospectus supplement and accompanying prospectus. The registration statement contains additional information about us and the notes being registered by this prospectus supplement and accompanying prospectus. We file with or submit to the SEC annual, quarterly and current periodic reports, proxy statements and other information meeting the informational requirements of the Exchange Act. This information and the information specifically regarding how we voted proxies relating to portfolio securities for the period ended June 30, 2016, are available free of charge by contacting us at 10 East 40th Street, 42nd floor, New York, NY 10016 or by telephone at toll-free (888) 748-0702. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the Public Reference Room of the SEC at 100 F Street NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. The SEC maintains an Internet site that contains reports, proxy and information statements and other information filed electronically by us with the SEC which are available on the SEC's Internet site at http://www.sec.gov. Copies of these reports, proxy and information statements and other information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the SEC's Public Reference Section, Washington, D.C. 20549-0102.

No dealer, salesperson or other individual has been authorized to give any information or to make any representation other than those contained in this prospectus supplement and accompanying prospectus and, if given or made, such information or representations must not be relied upon as having been authorized by us or the Purchasing Agent or any agent. This prospectus supplement does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction in which such an offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so, or to any person to whom it is unlawful to make such offer or solicitation. Neither the delivery of this prospectus supplement and accompanying prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in our affairs or that information contained herein is correct as of any time subsequent to the date hereof.

INDEX TO FINANCIAL STATEMENTS

Financial Statements

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
(in thousands, except share and per share data)

	September 30, 2016 (Unaudited)	June 30, 2016 (Audited)
Assets		
Investments at fair value:		
Control investments (amortized cost of $1,870,228 and $1,768,220, respectively)	$1,867,823	$1,752,449
Affiliate investments (amortized cost of $8,530 and $10,758, respectively)	6,966	11,320
Non-control/non-affiliate investments (amortized cost of $4,422,436 and $4,312,122, respectively)	4,234,807	4,133,939
Total investments at fair value (amortized cost of $6,301,194 and $6,091,100, respectively)	6,109,596	5,897,708
Cash	132,240	317,798
Receivables for:		
Interest, net	9,920	12,127
Other	197	168
Prepaid expenses	703	855
Deferred financing costs on Revolving Credit Facility (Note 4)	6,834	7,525
Total Assets	6,259,490	6,236,181
Liabilities		
Revolving Credit Facility (Notes 4 and 8)	44,000	—
Prospect Capital InterNotes® (Notes 7 and 8)	930,814	893,210
Convertible Notes (Notes 5 and 8)	908,240	1,074,361
Public Notes (Notes 6 and 8)	736,821	699,368
Interest payable	33,086	40,804
Due to broker	80,397	957
Due to Prospect Capital Management (Note 13)	51,091	54,149
Due to Prospect Administration (Note 13)	1,719	1,765
Accrued expenses	2,764	2,259
Other liabilities	5,113	3,633
Dividends payable	29,836	29,758
Total Liabilities	2,823,881	2,800,264
Commitments and Contingencies (Note 3)	—	—
Net Assets	$3,435,609	$3,435,917
Components of Net Assets		
Common stock, par value $0.001 per share (1,000,000,000 common shares authorized; 358,042,158 and 357,107,231 issued and outstanding, respectively) (Note 9)	$358	$357
Paid-in capital in excess of par (Note 9)	3,973,957	3,967,397
Accumulated overdistributed net investment income	(11,643)	(3,623)
Accumulated net realized loss	(335,465)	(334,822)
Net unrealized loss	(191,598)	(193,392)
Net Assets	$3,435,609	$3,435,917
Net Asset Value Per Share (Note 16)	$9.60	$9.62

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)
(Unaudited)

	Three Months Ended September 30, 2016	2015
Investment Income		
Interest income:		
Control investments	$45,909	$51,944
Affiliate investments	—	885
Non-control/non-affiliate investments	86,660	93,708
Structured credit securities	39,081	44,766
Total interest income	171,650	191,303
Dividend income:		
Control investments	2,240	3,213
Non-control/non-affiliate investments	144	2
Total dividend income	2,384	3,215
Other income:		
Control investments	2,940	2,409
Non-control/non-affiliate investments	2,858	3,324
Total other income (Note 10)	5,798	5,733
Total Investment Income	179,832	200,251
Operating Expenses		
Investment advisory fees:		
Base management fee (Note 13)	30,792	32,954
Income incentive fee (Note 13)	19,730	22,810
Interest and credit facility expenses	41,669	41,957
Allocation of overhead from Prospect Administration (Note 13)	3,533	4,178
Audit, compliance and tax related fees	1,395	1,877
Directors’ fees	113	94
Other general and administrative expenses	3,681	5,139
Total Operating Expenses	100,913	109,009
Net Investment Income	78,919	91,242
Net Realized and Change in Unrealized Gains (Losses)		
Net realized gains (losses)		
Control investments	—	—
Affiliate investments	137	—
Non-control/non-affiliate investments	572	(2,134)
Foreign currency transactions	5	(1)
Net realized gains (losses)	714	(2,135)
Net change in unrealized gains (losses)		
Control investments	13,345	(39,852)
Affiliate investments	(2,126)	105
Non-control/non-affiliate investments	(9,446)	(21,197)
Foreign currency translations	21	(331)
Net change in unrealized gains (losses)	1,794	(61,275)
Net Realized and Change in Unrealized Gains (Losses)	2,508	(63,410)

Net realized losses on extinguishment of debt	(61)	(15)
Net Increase in Net Assets Resulting from Operations	$81,366	$27,817
Net increase in net assets resulting from operations per share	$0.23	$0.08
Dividends declared per share	$(0.25)	$(0.25)

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(in thousands, except share data)
(Unaudited)

	Three Months Ended September 30,	
	2016	2015
Operations		
Net investment income	$78,919	$91,242
Net realized gains (losses)	653	(2,150)
Net change in unrealized gains (losses)	1,794	(61,275)
Net Increase in Net Assets Resulting from Operations	81,366	27,817
Distributions to Shareholders		
Distribution from net investment income	(89,428)	(89,115)
Net Decrease in Net Assets Resulting from Distributions to Shareholders	(89,428)	(89,115)
Common Stock Transactions		
Offering costs from issuance of common stock	—	118
Repurchase of common stock under stock repurchase program	—	(31,530)
Value of shares issued through reinvestment of dividends	7,754	3,682
Net Increase (Decrease) in Net Assets Resulting from Common Stock Transactions	7,754	(27,730)
Total Decrease in Net Assets	(308)	(89,028)
Net assets at beginning of period	3,435,917	3,703,049
Net Assets at End of Period	$3,435,609	$3,614,021
Common Stock Activity		
Shares repurchased under stock repurchase program	—	(4,358,750)
Shares issued through reinvestment of dividends	934,927	490,473
Net shares issued (repurchased) due to common stock activity	934,927	(3,868,277)
Shares issued and outstanding at beginning of period	357,107,231	359,090,759
Shares Issued and Outstanding at End of Period	358,042,158	355,222,482

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, except share data)
(Unaudited)

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015
Operating Activities		
Net increase in net assets resulting from operations	$81,366	$27,817
Net realized losses on extinguishment of debt	61	15
Net realized (gains) losses on investments and foreign currency transactions	(714)	2,135
Net change in unrealized (gains) losses on investments and foreign currency transactions	(1,794)	61,275
Amortization of discounts and premiums, net	23,439	24,072
Accretion of discount on Public Notes (Note 6)	64	49
Amortization of deferred financing costs	3,631	3,556
Payment-in-kind interest	(5,439)	(1,279)
Structuring fees	(3,028)	(3,556)
Change in operating assets and liabilities:		
Payments for purchases of investments	(338,683)	(340,908)
Proceeds from sale of investments and collection of investment principal	114,331	436,919
Decrease in interest receivable, net	2,207	6,029
(Increase) decrease in other receivables	(29)	1,978
Decrease in prepaid expenses	152	32
Increase in due to broker	79,440	28,475
Decrease in interest payable	(7,718)	(4,020)
(Decrease) increase in due to Prospect Administration	(46)	1,177
Decrease in due to Prospect Capital Management	(3,058)	(2,388)
Increase (decrease) in accrued expenses	505	(45)
Increase in other liabilities	1,480	3,021
Net Cash (Used in) Provided by Operating Activities	(53,833)	244,354
Financing Activities		
Borrowings under Revolving Credit Facility (Note 4)	44,000	200,000
Principal payments under Revolving Credit Facility (Note 4)	—	(412,000)
Issuances of Public Notes, net of original issue discount (Note 6)	37,466	—
Redemptions of Convertible Notes (Note 5)	(167,500)	—
Issuances of Prospect Capital InterNotes® (Note 7)	38,917	48,134
Redemptions of Prospect Capital InterNotes®, net (Note 7)	(1,979)	(628)
Financing costs paid and deferred	(1,033)	(891)
Cost of shares repurchased under stock repurchase program	—	(31,530)
Offering costs from issuance of common stock	—	118
Dividends paid	(81,596)	(85,755)
Net Cash Used in Financing Activities	(131,725)	(282,552)
Net Decrease in Cash	(185,558)	(38,198)
Cash at beginning of period	317,798	110,026
Cash at End of period	$132,240	$71,828
Supplemental Disclosures		
Cash paid for interest	$44,542	$43,004
Non-Cash Financing Activities		

Value of shares issued through reinvestment of dividends	$7,754	$3,682

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	September 30, 2016 (Unaudited) Principal Value / Amortized Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS					
Control Investments (greater than 25.00% voting control)(40)					
Arctic Energy Services, LLC(15)	Wyoming / Oil & Gas Services	Class D Units (32,915 units)	$ 31,640	$ 20,167	0.6%
		Class E Units (21,080 units)	20,230	—	—%
		Class A Units (700 units)	9,006	—	—%
		Class C Units (10 units)	—	—	—%
			60,876	20,167	0.6%
CCPI Inc.(16)	Ohio / Manufacturing	Senior Secured Term Loan A (10.00%, due 12/31/2017)(3)	12,200	12,200	0.4%
		Senior Secured Term Loan B (12.00% plus 7.00% PIK, due 12/31/2017)(39)	9,320	9,320	0.3%
		Common Stock (14,857 shares)	6,759	20,722	0.5%
			28,279	42,242	1.2%
CP Energy Services Inc.(17)	Oklahoma / Oil & Gas Services	Series B Convertible Preferred Stock (1,043 shares)	98,273	76,002	2.2%
		Common Stock (2,924 shares)	15,227	—	—%
			113,500	76,002	2.2%
Credit Central Loan Company, LLC(18)	South Carolina / Consumer Finance	Subordinated Term Loan (10.00% plus 10.00% PIK, due 6/26/2019)(13)(39)	50,510 / 42,989	50,510	1.5%
		Class A Shares (10,640,642 shares)(13)	13,731	9,341	0.3%
		Net Revenues Interest (25% of Net Revenues)(13)	—	4,069	0.1%
			56,720	63,920	1.9%
Echelon Aviation LLC	New York / Aerospace & Defense	Senior Secured Term Loan (11.75% (LIBOR + 9.75% with 2.00% LIBOR floor) plus 2.25% PIK, due 3/31/2022)(10)(12)(39)	31,055	31,055	0.9%
		Membership Interest (99%)	19,907	23,988	0.7%
			50,962	55,043	1.6%
Edmentum Ultimate Holdings, LLC(19)	Minnesota / Consumer Services	Second Lien Revolving Credit Facility to Edmentum, Inc. – $7,834 Commitment (5.00%, due 6/9/2020)(14)	——	—	—%
		Unsecured Senior PIK Note (8.50% PIK, due 6/9/2020)(39)	6,478	6,478	0.2%
		Unsecured Junior PIK Note (10.00% PIK, due 6/9/2020)(39)	29,571 / 23,073	24,766	0.7%
		Class A Common Units (370,964 units)	6,577	4,241	0.1%
			36,128	35,485	1.0%
First Tower Finance Company LLC(20)	Mississippi / Consumer Finance	Subordinated Term Loan to First Tower, LLC (10.00% plus 12.00% PIK, due	256,578	256,578	7.5%

		6/24/2019)(13)(39)			
		Class A Shares (86,711,625 shares)(13)	70,476	95,275	2.7%
			327,054	351,853	10.2%
Freedom Marine Solutions, LLC(21)	Louisiana / Oil & Gas Services	Membership Interest (100%)	41,411	26,671	0.8%
			41,411	26,671	0.8%
Gulf Coast Machine & Supply Company	Texas / Manufacturing	Senior Secured Term Loan (10.50% (LIBOR + 8.50% with 2.00% LIBOR floor), in non-accrual status effective 1/1/2015, due 10/12/2017)(10)(11)	38,906 33,403	7,394	0.2%
		Series A Convertible Preferred Stock (99,900 shares)	25,950	—	—%
			59,353	7,394	0.2%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	September 30, 2016 (Unaudited) Principal Value	Amortized Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Control Investments (greater than 25.00% voting control)(40)						
MITY, Inc.(22)	Utah / Durable Consumer Products	Senior Secured Note A (10.00% (LIBOR + 7.00% with 3.00% LIBOR floor), due 3/19/2019)(3)(10)(11)	$18,250	$ 18,250	$18,250	0.5%
		Senior Secured Note B (10.00% (LIBOR + 7.00% with 3.00% LIBOR floor) plus 10.00% PIK, due 3/19/2019)(3)(10)(11)(39)	16,442	16,442	16,442	0.5%
		Subordinated Unsecured Note to Broda Enterprises ULC (10.00%, due on demand)(13)	5,646	7,200	5,646	0.2%
		Common Stock (42,053 shares)		6,849	13,177	0.4%
				48,741	53,515	1.6%
National Property REIT Corp.(23)	Various / Real Estate	Senior Secured Term Loan A (6.00% (LIBOR + 4.00% with 2.00% LIBOR floor) plus 5.50% PIK, due 4/1/2019)(10)(11)(39)	283,972	283,972	283,972	8.3%
		Senior Secured Term Loan E (11.00% (LIBOR + 9.00% with 2.00% LIBOR floor) plus 5.00% PIK, due 4/1/2019)(10)(11)(39)	212,819	212,819	212,819	6.2%
		Senior Secured Term Loan C to ACL Loan Holdings, Inc. (11.00% (LIBOR + 9.00% with 2.00% LIBOR floor) plus 5.00% PIK, due 4/1/2019)(10)(11)(13)(39)	135,818	135,818	135,818	4.0%
		Senior Secured Term Loan C to American Consumer Lending Limited (11.00% (LIBOR + 9.00% with 2.00% LIBOR floor) plus 5.00% PIK, due 4/1/2019)(10)(11)(13)(39)	11,508	11,508	11,508	0.3%
		Common Stock (1,656,276 shares)	—	188,444	267,511	7.7%
		Net Operating Income Interest (5% of Net Operating Income)	—	—	68,362	2.0%
				832,561	979,990	28.5%
Nationwide Loan Company LLC(24)	Illinois / Consumer Finance	Senior Subordinated Term Loan to Nationwide Acceptance LLC (10.00% plus 10.00% PIK, due 6/18/2019)(13)(39)	16,819	16,819	16,819	0.5%
		Class A Shares (29,559,899 shares)(13)		16,292	20,690	0.6%
				33,111	37,509	1.1%

		Senior Secured Note (14.00%, due 5/6/2021)	3,714	3,714	3,404	0.1%
NMMB, Inc.(25)	New York / Media	Senior Secured Note to Armed Forces Communications, Inc. (14.00%, due 5/6/2021)	7,000	7,000	6,416	0.2%
		Series A Preferred Stock (7,200 shares)		7,200	28	—%
		Series B Preferred Stock (5,669 shares)		5,669	35	—%
				23,583	9,883	0.3%
R-V Industries, Inc.	Pennsylvania / Manufacturing	Senior Subordinated Note (10.00% (LIBOR + 9.00% with 1.00% LIBOR floor), due 6/12/2018)(3)(10)(11)	28,622	28,622	28,622	0.8%
		Common Stock (545,107 shares)		5,087	4,824	0.1%
		Warrant (to purchase 200,000 shares of Common Stock, expires 6/30/2017)		1,681	1,769	0.1%
				35,390	35,215	1.0%
USES Corp.(26)	Texas / Commercial Services	Senior Secured Term Loan A (9.00% PIK, in non-accrual status effective 4/1/2016, due 3/31/2019)	26,683	26,158	26,683	0.8%
		Senior Secured Term Loan B (15.50% PIK, in non-accrual status effective 4/1/2016, due 3/31/2019)	36,905	35,568	15,704	0.4%
		Common Stock (268,962 shares)		—	—	—%
				61,726	42,387	1.2%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	September 30, 2016 (Unaudited) Principal Value	Amortized Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Control Investments (greater than 25.00% voting control)(40)						
Valley Electric Company, Inc.(27)	Washington / Construction & Engineering	Senior Secured Note to Valley Electric Co. of Mt. Vernon, Inc. (8.00% (LIBOR + 5.00% with 3.00% LIBOR floor) plus 2.50% PIK, due 12/31/2019)(3)(10)(11)(39)	$10,430	$10,430	$10,430	0.3%
		Senior Secured Note (10.00% plus 8.50% PIK, due 6/23/2019)(39)	24,199	24,199	20,101	0.6%
		Common Stock (50,000 shares)		26,204	—	—%
				60,833	30,531	0.9%
Wolf Energy, LLC	Kansas / Oil & Gas Production	Senior Secured Promissory Note secured by assets formerly owned by H&M (18.00%, in non-accrual status effective 4/15/2013, due 4/15/2018)	38,257	—	—	—%
		Membership Interest (100%)		—	—	—%
		Net Profits Interest (8% of Equity Distributions)(4)		—	16	—%
				—	16	—%
				$1,870,228	$1,867,823	54.3%

Affiliate Investments (5.00% to 24.99% voting control)(41)

Targus International, LLC(28)	California / Durable Consumer Products	Senior Secured Term Loan A (15.00% PIK, in non-accrual status effective 10/1/15, due 12/31/2019)(8)	$1,371	$1,263	$1,371	—%
		Senior Secured Term Loan B (15.00% PIK , in non-accrual status effective 10/1/15, due 12/31/2019)(8)	4,113	3,788	4,113	0.2%
		Common Stock (1,262,737 shares)		3,479	1,482	—%
				8,530	6,966	0.2%
				$8,530	$6,966	0.2%

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

			September 30, 2016 (Unaudited)			
Portfolio Company	Locale / Industry	Investments(1)	Principal Value	Amortized Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
AFI Shareholder, LLC (f/k/a Aircraft Fasteners International, LLC)	California / Machinery	Class A Units (32,500 units)		$ 309	$ 617	—%
				309	617	—%
ALG USA Holdings, LLC	Pennsylvania / Hotels, Restaurants & Leisure	Second Lien Term Loan (10.25% (LIBOR + 9.00% with 1.25% LIBOR floor), due 2/28/2020)(8)(10)(11)	11,770	11,640	11,771	0.3%
				11,640	11,771	0.3%
American Gilsonite Company(29)	Utah / Metal Services & Minerals	Membership Interest (1.93%)		—	—	—%
				—	—	—%
Apidos CLO IX	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.72%, due 7/15/2023)(5)(13)	23,525	19,651	18,919	0.6%
				19,651	18,919	0.6%
Apidos CLO XI	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 11.36%, due 1/17/2023)(5)(13)	38,340	29,137	25,439	0.7%
				29,137	25,439	0.7%
Apidos CLO XII	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 13.25%, due 4/15/2025)(5)(13)	44,063	33,470	29,888	0.9%
				33,470	29,888	0.9%
Apidos CLO XV	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 9.22%, due 10/20/2025)(5)(13)	36,515	30,624	24,264	0.7%
				30,624	24,264	0.7%
Apidos CLO XXII	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 16.19%, due 10/20/2027)(5)(6)(13)	31,350	26,735	24,751	0.7%
				26,735	24,751	0.7%
Arctic Glacier U.S.A., Inc.	Minnesota / Food Products	Second Lien Term Loan (10.50% (LIBOR + 9.25% with 1.25% LIBOR floor), due 11/10/2019)(3)(10)(11)		150,000	149,324	4.3%
				150,000	149,324	4.3%
			20,302	10,706	$ 9,568	0.3%

Ark-La-Tex Wireline Services, LLC	Louisiana / Oil & Gas Services	Senior Secured Term Loan A (6.50% (LIBOR + 5.50% with 1.00% LIBOR floor), in non-accrual status effective 4/1/2016, due 4/8/2019)(10)(12)			
		Senior Secured Term Loan B (12.50% (LIBOR + 11.50% with 1.00% LIBOR floor), in non-accrual status effective 4/1/2016, due 4/8/2019)(10)(12)	24,239 / 23,759	—	—%
			43,945	9,568	0.3%
Armor Holding II LLC	New York / Diversified Financial Services	Second Lien Term Loan (10.25% (LIBOR + 9.00% with 1.25% LIBOR floor), due 12/26/2020)(3)(8)(10)(11)	7,000 / 6,912	6,912	0.2%
			6,912	6,912	0.2%
Atlantis Health Care Group (Puerto Rico), Inc.	Puerto Rico / Healthcare	Revolving Line of Credit – $7,000 Commitment (10.25% (LIBOR + 8.25% with 2.00% LIBOR floor), due 8/21/2017)(10)(11)(14)	2,350	2,350	0.1%
		Senior Term Loan (10.25% (LIBOR + 8.25% with 2.00% LIBOR floor), due 2/21/2018)(3)(10)(11)	38,067	38,067	1.1%
			40,417	40,417	1.2%
Babson CLO Ltd. 2014-III	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 13.09%, due 1/15/2026)(5)(6)(13)	52,250 / 42,771	40,630	1.2%
			42,771	40,630	1.2%

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

			September 30, 2016 (Unaudited)			
Portfolio Company	Locale / Industry	Investments(1)	Principal Value	Amortized Cost	Fair Value(2)	% of Net Assets

LEVEL 3 PORTFOLIO INVESTMENTS