

SMARTHEAT INC.
Form 424B5
September 18, 2009
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Filed Pursuant to Rule 424(b)(5)
Registration No. 333-160190

PROSPECTUS SUPPLEMENT

(to Prospectus dated August 6, 2009)

7,246,087 Shares

SmartHeat, Inc.

Common Stock

We are offering 7,246,087 shares of our common stock at a price of \$9.00 per share.

Our common stock trades on The NASDAQ Global Market under the symbol HEAT. The last reported sale price of our common stock on September 17, 2009 was \$10.06 per share.

Investing in our common stock involves risk. See Risk Factors beginning on page S-11 of this prospectus supplement.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	\$ 9.00	\$ 65,214,783
Underwriting discounts and commissions	\$ 0.63	\$ 4,565,035
Proceeds, before expenses, to us	\$ 8.37	\$ 60,649,748

We have granted the underwriters an option for a period of 30 days from the date of this prospectus supplement to purchase up to an additional 1,086,913 shares of our common stock on the same terms and conditions set forth above to cover over-allotments, if any.

The underwriters expect to deliver the shares of our common stock on or about September 22, 2009.

Sole Book-Running Manager

Co-Lead Manager

William Blair & Company

BMO Capital Markets

The date of this prospectus supplement is September 17, 2009.

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ABOUT THIS PROSPECTUS SUPPLEMENT

This prospectus supplement and the accompanying prospectus are part of a shelf registration statement on Form S-3 (File No. 333-160190) that we filed with the Securities and Exchange Commission, or the SEC, and that was declared effective by the SEC on August 6, 2009. This prospectus supplement describes the specific details regarding this offering, including the price, the amount of our common stock being offered, certain risks of investing in our common stock and other items. The accompanying prospectus provides additional information. You should read this entire prospectus supplement as well as the accompanying prospectus and the documents incorporated by reference that are described under "Where You Can Find More Information" in this prospectus supplement and the accompanying prospectus. In the event that the description of the offering varies between this prospectus supplement and the accompanying prospectus, you should rely on the information contained in this prospectus supplement.

You should rely only on the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus prepared by or on behalf of us, or information to which we have referred you. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein is accurate only as of the respective dates of those documents in which the information is contained, regardless of the time of delivery of this prospectus supplement or of any sale of the securities. Our business, financial condition, results of operations and prospects may have changed since those dates.

The terms SmartHeat, Company, we, our or us in this prospectus supplement refer to SmartHeat, Inc. and its subsidiaries, unless the context suggests otherwise. Additionally, unless we indicate otherwise, references in this prospectus supplement to:

China and the PRC are to the People's Republic of China, excluding, for the purposes of this prospectus only, Taiwan and the special administrative regions of Hong Kong and Macau;

RMB and Renminbi are to the legal currency of China; and

\$, US\$ and U.S. dollars are to the legal currency of the United States.

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PROSPECTUS SUPPLEMENT SUMMARY

The following summary highlights selected information contained elsewhere in this prospectus supplement, the accompanying prospectus and the documents incorporated herein by reference. This summary does not contain all of the information you should consider before investing in our common stock. Before deciding to invest in shares of our common stock, you should read this entire prospectus supplement, the accompanying prospectus and the documents incorporated herein and therein, including the discussion of Risk Factors and our consolidated financial statements and the related notes. Moreover, the information contained in this prospectus supplement includes forward-looking statements, which are based on current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments actually affecting us will be those anticipated. Please see page 1 of the accompanying prospectus for cautionary information regarding forward-looking statements.

Our Company

We are a leading designer, manufacturer and seller of clean technology heat exchangers and related systems in the People's Republic of China (China). Our products are used by our customers in the industrial, residential and commercial markets in China to improve energy utilization and efficiencies and reduce pollution by reducing the need for coal fired boilers. We design, manufacture, sell and service plate heat exchangers (PHEs), PHE units, which combine PHEs with various pumps, temperature sensors, valves and automated control systems (PHE Units), and heat meters for use in commercial and residential buildings. Our products and systems are an important element in providing a clean technology, mission-critical solution to energy consumption and air pollution problems in China and are commonly used in a wide variety of industrial processes where heat transfer is required. Common applications include energy conversion for heating, ventilation and air conditioning (HVAC) and industrial use in petroleum refining, petrochemicals, metallurgy, food and beverage and chemical processing. Our PHE Units are custom designed by our own in-house engineers and sold under our own Taiyu brand name, while our PHEs are sold under both our Taiyu brand as well as the Sondex brand name. We are also the sole authorized dealer of Sondex PHEs for northern China.

A PHE is a device that transfers energy from one fluid to another across a solid surface. PHEs are made of stainless steel, titanium or nickel alloy plates that are sealed by gaskets and then bolted together in a large metal frame that holds the plates together. Plates come in a variety of sizes and wave patterns, have large heat transfer surfaces and high thermal conductivity. The quantity and size of the plates and size of the PHEs and PHE Units vary according to particular application requirements.

Among the primary advantages of plate heat exchangers as compared to traditional shell and tube heat exchangers is their efficiency, compact design and ease of customization. PHEs have larger heat transfer surface areas and therefore greater thermal conductivity. As a result, PHEs can transfer the same amount of heat as a traditional shell and tube heat exchanger despite the small size of the PHE. In China, coal is the predominant source of heat energy, and coal burning is a significant contributor to carbon dioxide (CO₂) emissions. According to the report entitled International Energy Annual 2006 World Energy Overview 1996-2006 published by the Energy Information Administration, a subdivision of the United States Department of Energy, in 2006, the consumption of coal was the world's largest source of CO₂ emissions from the consumption and flaring of fossil fuels, accounting for 41% of the total. China was the largest producer of CO₂ from the consumption of coal in 2006, accounting for 41% of the world total. The PRC government's 11th Five-Year Plan (the 11th Five-Year Plan), announced in 2006, targeted a 20% reduction in energy consumption per unit of GDP and a 10% reduction in industry expulsion of pollutant particles by 2010. As the Chinese government begins to require the use of machines that produce more efficient heat transfer and utilize waste heat energy, PHEs will be an important element in reducing overall coal consumption in China, which will translate into lower heating costs, lower CO₂ emissions for users and less pollution to the environment.

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We currently focus exclusively on the Chinese market. All designs of our PHEs and PHE Units are done in-house by our engineers utilizing advanced software and our proprietary in-house CAD software. In May of 2009, we acquired the production assets of Siping Beifang Heat Exchanger, Manufacture Co., Ltd. (Siping Beifang), one of the major plate heat exchanger manufacturers in China, and began a program to vertically integrate our supply chain for our own PHE components and, at the same time, supplement our relationship with our main supplier, Sondex. As a result, we now manufacture our own plates and can design and manufacture PHEs and PHE Units using either supply source for the component plates. Our new plates provide solutions for a market segment with strong demand for PHE products that are priced 10-15% lower than PHE products with Sondex plates.

In early 2006 we launched a third product line, heat meters, which utilize the same sales channels and allow us to provide heat consumption information to users. Heat meters precisely measure the volume of heat usage, which is an important revenue stream for utility companies. While home owners commonly use heat meters in western countries, widespread incorporation of heat meters has only recently taken hold in China. As of July 2003, heat meters were required nationally by law for new construction installed with central heating and the law was extended in April of 2008 by the Energy Conservation Law, Article 38, to existing buildings being retrofitted. This law implies that heat meters be installed in new residential construction and retrofitted buildings. We believe there are significant opportunities for strong incremental growth as the Chinese government continues to focus on ways to cost effectively monitor and conserve energy.

PHE

PHE Unit

Heat Meter

From 2006 to 2008, our total revenue increased from \$8.2 million to \$32.7 million, a compound annual growth rate (CAGR) of 99.6% and had reached \$42.7 million for the twelve-month period ending June 30, 2009. Our net income has grown at a 175.8% CAGR from \$0.8 million in 2006 to \$6.3 million in 2008 and had reached \$8.8 million for the twelve-month period ending June 30, 2009.

Our company is headquartered in Shenyang China where we have a 210,137 square foot state of the art production facility. We operate two other production and assembly facilities in China. As of June 30, 2009 we had approximately 500 regular full-time employees and approximately 170 seasonal employees.

Our Industry

We address the utility and industrial sectors throughout China. Participants in these industries are large users of PHEs, PHE Units and accessories. We also address the HVAC sector. Participants in this industry are large users of heat meters. The China District Heating Association, a non-profit organization consisting of manufacturers of heating products, stated in a presentation to members in September of 2007, that the domestic market for PHEs was approximately \$2.4 billion in 2007 and estimated the market will grow at an annual rate of about 30% through 2010. Part of this market includes PHE Units, which were estimated to grow at an annual rate of 70% through 2010.

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Currently, there are social, economic, environmental, regulatory and government stimulus-related factors driving demand for environmentally-friendly solutions which reduce pollution and advance energy efficiency, many of which utilize PHEs. These include:

Environmental Conditions in China. According to the report entitled International Energy Annual 2006 World Energy Overview 1996-2006 published by the Energy Information Administration, a subdivision of the United States Department of Energy, in 2006, the consumption of coal was the world's largest source of carbon dioxide emissions from the consumption and flaring of fossil fuels, accounting for 41% of the world total. China was the largest producer of carbon dioxide from the consumption of coal in 2006, accounting for 41% of the world total. According to a joint report by the World Bank and Environmental Protection Administration, the economic burden of premature mortality and morbidity associated with air pollution was \$23 billion in 2003, or 1.16% of GDP. PHEs and PHE Units help to alleviate this problem through energy efficient technology that reduces the amount of coal consumption and CO₂ emissions traditionally associated with heat production.

Growing Demand for Heating Water. China currently provides households throughout 17 of its 34 northern provinces with heating water. As new cities grow along with the emerging middle class, so does the demand to expand this supply into new cities, industrial parks and other provinces. Heating water in China is generated by local power plants which pump emitted hot water from the power plant through a closed loop system to a water heating company and then through a network of pipes up to a distance of 50 kilometers. These systems of heating stations and sub-stations utilize numerous PHEs and PHE Units, which provide a dual purpose: a cooling system for the power plants and a heat source for residents and factories.

Heightened Environmental Awareness. In March 2006, China announced its 11th Five-Year Plan that set new pollution reduction standards, targeting a 20% reduction in energy consumption per unit of GDP and a 10% reduction in industry expulsion of pollutant particles by 2010. The implementation of PHEs and PHE Units in new construction facilities, and as replacements for legacy shell-and-tube heat exchangers, can help meet these goals because of their increased energy efficiency.

Urbanization. According to the CIA World Factbook, 43% of China's population lived in urban settings in 2008. Additionally, according to the National Bureau of Statistics of China, 15 cities near and around SmartHeat's sales and service centers have a population of more than five million and eight Chinese cities are among the world's fastest growing, increasing at an annual rate of 2.5% or more. China's urbanization and city population growth have led to new infrastructure development and existing infrastructure improvements that require ongoing investment in heating solutions.

Government Stimulus. On November 5th, 2008, China's State Council approved a \$586 billion plan to invest in infrastructure and social welfare. On March 6th, 2009, China's National Development and Reform Commission announced a revision of the stimulus. The new revision includes \$31 billion, a portion of which will be allocated to energy-saving projects, and \$59 billion to affordable housing. These funds must be spent by the end of 2010.

Emerging Wealth. The rapidly expanding middle class is demanding access to quality heating during the winter months, and the source of such heating is often from hot water supplied from a power station and district heating network utilizing a system of PHEs and PHE Units.

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Our Competitive Strengths

We believe we have the following competitive strengths:

Provider of Key Elements Used to Improve Energy Efficiencies and Reduce Coal Pollution. We offer a full line of PHEs, PHE Units and heat meters. The primary advantages of plate heat exchanger technology, compared to traditional shell and tube heat exchanger technology, are efficiency, compact design and ease of customization. PHEs have larger heat transfer surface areas and therefore greater thermal conductivity. As a result, PHEs can transfer the same amount of heat as a traditional shell and tube heat exchanger with a smaller size unit.

Established Leader and Brand Name in the Growing China Heating Industry. We have established a leading brand name in the fragmented Chinese heating industry and we seek to utilize this awareness to become the leading Chinese supplier of PHEs, PHE Units and related products to the rapidly growing Chinese market. We are a leading domestic producer of PHE Units under the Taiyu brand, with a 2007 market share of approximately 8% in China according to the China District Heating Association. We believe the Taiyu brand name is recognized for quality and efficiency, which we can leverage to improve our reputation as a leading seller of high quality PHE Units in China.

Quality Engineering, Research and Development. We emphasize efficiency, durability and quality engineering in all of our products. All of our products utilize the latest technologies, and our designs are created using advanced software systems. We have eight registered patents in China for PHE products and heat meters. We have two patents for our plate heat exchangers, one for our heat transfer system for space heating and domestic hot water, one for a heat meter cleaning pipe, two for our heat meter testing system, one for an integrated heat transfer system and one for an efficient-heat testing bench. Five of our patents expire in 2014, one expires in 2016 and two expire in 2017. To maintain our competitive edge in the marketplace and keep pace with new technologies, we fund research and development on an on-going basis to find improved efficiencies in design, cost and energy capture. Research and development costs for 2007 and 2008 were \$343,800 and \$1,020,000, respectively. We plan to continue to invest in research and development to identify new industry applications for PHEs, improve our product lines, develop multifunctional PHE Units and modify PHE designs to meet the current market demand.

Strong Technical Support. The selection of PHEs and PHE Units requires technical knowledge regarding the operating temperature, pressure, corrosivity, viscosity and purity of the fluid as well as the pressure loss within the system. Our unique design software enables us to provide high quality and timely technical support to ensure our customers receive the right equipment for each project. We also provide a streamlined and error free installation process to minimize project complications.

Enterprise-Wide Design, Production and Control Systems for Efficient Pricing and Streamlined Manufacturing. Our technologically advanced CAD design systems are integrated with our real-time enterprise resource planning (ERP) and finance systems. This advanced, integrated platform allows our field salespeople to input orders, obtain draft models, access quotes and confirm delivery dates within minutes. The platform also enables inventory and production personnel to accurately schedule and reduce lead production times to five days for PHEs and ten days for PHE Units. We believe these lead times are some of the best in the industry and create a differentiated level of customer service.

Focus on Quality. We have a National Safety Certification for our PHE products, and are an ISO 9001 certified manufacturer.

First Rate Customer Service and Reliable Product Delivery. We believe that our employees provide first rate customer service, technical expertise and product knowledge to streamline the selection, design and

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installation processes. We provide after sale service through our local service centers and deliver products on time to meet tight project deadlines. Our focus on delivering premium service separates us from our competitors and has been critical in helping us win a number of projects for various multinational companies and local governments.

Diversified End Markets and Customers. Our PHEs and PHE Units are broadly used across a variety of industrial end markets including the energy (i.e., conventional and nuclear power plants), HVAC, petroleum refining, petrochemicals, metallurgy, food and beverage and chemical processing end markets. We also benefit from a diverse customer mix. For the fiscal year ended December 31, 2008, our ten largest customers accounted for 32% of sales and our largest customer accounted for approximately 6% of sales. In addition, in 2008, 48% of our sales were from existing customers. This end market and customer diversification helps to insulate us from sales volatility that would occur if we concentrated in specific industries. The bulk of our customers are utilities, engineering and construction companies and industrial companies.

Proven Ability to Identify and Acquire Strategic Targets. Over the past 12 months, we have completed two strategic acquisitions. Each acquisition has accelerated our strategic plan by: (i) adding manufacturing capacity; (ii) broadening our product offering to include multiple heat exchange systems; (iii) facilitating access into new geographic regions throughout China; (iv) improving our cost structure; (v) enhancing our engineering capabilities; or (vi) helping us enter new and higher growth end markets. We have proven our ability to complete successful acquisitions and believe there are additional acquisition opportunities which we may potentially pursue.

Experienced Management Team. Our senior management team has extensive business and industry experience. Mr. Jun Wang, our president and CEO, was the founder of Taiyu in 2002. He was a sales manager for Honeywell International Inc. from 1996 to 1999 and was a sales manager for Alfa Laval from 1994 to 1996. Mr. Wang obtained his Master's degree in Engineering from Tsinghua University in 1989. Ms. Zhijuan Guo, our CFO, has 14 years of finance and accounting experience and has been with the Company since its inception in 2002. Mr. Wen Sha, our VP of marketing, has extensive sales experience and industry contacts. He joined SmartHeat as a Regional Sales Manager in 2005. Prior to that, he served as the General Manager of Nanjing Hui Dun Ltd. and as sales director of APV Accessen in Shanghai, a leading international PHE firm. Mr. Feng Chen, Ph.D., our CTO, joined SmartHeat in 2008 as part of our SanDeKe acquisition. Prior to founding SanDeKe, he served in a leading engineering position in China with Alfa Laval.

Our Growth Strategy

Our goal is to further penetrate the many market segments throughout China for PHEs, PHE Units and related accessories, expand our PHE Unit sales, promote the sale of heat meters and execute strategic acquisitions that are accretive and synergistic to our business.

Pursue High Growth Chinese End Markets. We are targeting our sales efforts on a number of high growth Chinese end markets such as power and petrochemical. We currently have a presence in these segments but believe there are significant opportunities to improve our market share by leveraging our premium product quality and high quality service. Our solutions are commonly used in many of these industries and customers continue to assess the cost savings and positive environmental attributes of PHEs.

Capitalize upon Strong Industry Dynamics in China. Continued economic growth in China, coupled with evolving government policy and increasing environmental consciousness, present us with significant future growth opportunities. The 11th Five-Year Plan targeted a 20% reduction in energy consumption per unit of GDP and a 10% reduction in industry expulsion of pollutant particles by 2010. We believe that this mandate will force whole industries to allocate major portions of their infrastructure and energy investments into energy efficient, green technologies such as PHEs and PHE Units. Management believes this growth will be accelerated as significant investments in district heating systems and co-generation power plants come on-line in the next few years.

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Continue Organic Growth Initiatives. We believe that the current PHE market is fragmented and represents an excellent opportunity for us to gain additional market share from our competitors. We intend to open new sales offices, hire additional sales personnel, expand into new distribution channels and improve the quality of our products. We also intend to leverage our strong brand, quality customer service, engineering and reliable product delivery to gain incremental business with our existing clients. Finally, we believe that as we continue to grow, economies of scale and improved cost control measures will drive stronger profitability across all product lines.

Continue to Expand PHE Unit Sales. The production and sale of PHE Units has been vital to our growth. PHE Units require a high level of technical skill and knowledge of the applications in which they are used, allowing for premium pricing and creating a barrier to entry for competitors attempting to enter the market. Less than five years after entering the market, we have emerged as a leading domestic producer of PHE Units, with a 2007 market share of approximately 8% according to the China District Heating Association. We are focused on continuing to pursue sales of higher value-added PHE Units and, as a recognized brand, believe we are well-positioned to capture incremental market share in a category that is projected to grow 70% per year through 2010 by the China District Heating Association.

Promote Heat Meters. In response to rising energy costs and an increased focus on energy efficiency, the Chinese government and local utility companies have made the use of heat meters compulsory in China. As of July 2003, heat meters were required nationally by law for new buildings installed with central heating and the law was extended in April of 2008 by the Energy Conservation Law, Article 38, to buildings being retrofitted. We plan to work with the various government entities to establish a national heating standard and intend to leverage the Taiyu brand and our superior quality to gain market share in this market.

Execute Strategic Acquisitions. We intend to continue to selectively acquire domestic targets that would enable us to enter new customer segments or gain entry into new industries. For instance, the recent acquisition of the plant and machinery and land use rights from Siping Beifang provided us with an entrance into the petrochemical and high pressure chemical end markets, which were previously immaterial segments for us. Due to the high pressure and heat tolerance demands of the petrochemical industry, we have also acquired valuable engineering expertise that may help us address the nuclear energy segment in a meaningful way. We will continue to identify and review targets that are accretive to our earnings, easily integrated into our existing infrastructure and synergistic to our operations.

Risk Factors

Please see **Risk Factors** starting on page S-11 to read about factors you should consider carefully before deciding to invest in shares of our common stock.

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The Offering

Common stock offered by us 7,246,087 shares

Common stock to be outstanding immediately after this offering 31,451,162 shares

NASDAQ Global Market symbol HEAT

Use of proceeds For general corporate purposes, including expansion of our product offerings, capital expenditures and to meet working capital needs. See Use of Proceeds on page S-18. The total number of shares of common stock outstanding after this offering is based on 24,205,075 shares outstanding as of September 17, 2009. This number excludes an aggregate of up to 367,825 shares of our common stock issuable upon exercise of warrants outstanding as of September 17, 2009 at an exercise price of \$6.00 per share and stock options outstanding to purchase 20,000 shares of common stock at an exercise price of \$4.60 per share.

See Description of Common Stock in the accompanying prospectus for information regarding our common stock, our articles of incorporation and related Nevada law matters.

Unless we indicate otherwise, the information in this prospectus supplement assumes that the underwriters will not exercise their over-allotment option to purchase up to 1,086,913 additional shares of common stock from us.

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The following table sets forth our summary financial data for the periods indicated. You should read this information together with Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and related notes incorporated by reference into this prospectus supplement. Historical financial information may not be indicative of our future performance and the results for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the full fiscal year.

Consolidated Statement of Income Data:

	Six months ended June 30,		Year ended December 31,	
	2009	2008	2008	2007
	(unaudited)			
Net sales	\$ 18,705,898	\$ 8,637,283	\$ 32,676,082	\$ 13,273,151
Cost of sales	11,874,903	6,228,156	21,717,735	8,667,353
Gross profit	6,830,995	2,409,127	10,958,347	4,605,798
Total operating expenses	2,499,664	1,054,498	3,416,670	2,369,090
Income from operations	4,331,331	1,354,629	7,541,677	2,236,708
Total (other expenses) other income	(12,081)	115,074	93,289	24,957
Income before provision for income taxes	4,319,250	1,469,703	7,634,966	2,261,665
Provision for income taxes	680,432	266,028	1,293,660	175,647
Minority interest			5,966	(1,873)
Net income	\$ 3,638,818	\$ 1,203,675	\$ 6,335,340	\$ 2,087,891
Other comprehensive income foreign currency translation adjustments	13,143	410,896	510,770	333,449
Comprehensive income	3,651,961	1,614,571	6,846,110	2,421,340
Weighted average number of common shares basic	24,179,900	20,213,419	22,176,322	18,500,000
Weighted average number of common shares diluted	24,191,063	20,213,419	22,176,432	18,500,000
Earnings per share basic	\$ 0.15	\$ 0.06	\$ 0.29	\$ 0.11
Earnings per share diluted	\$ 0.15	\$ 0.06	\$ 0.29	\$ 0.11

Consolidated Balance Sheet Data:

	As of June 30, 2009
Cash & cash equivalents	\$ 2,408,714
Total assets	38,934,858
Total liabilities	17,389,455
Total stockholders' equity	21,545,403

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RISK FACTORS

An investment in our common stock involves a high degree of risk. In addition to the following risk factors, you should carefully consider the risks, uncertainties and assumptions discussed under Risk Factors in the accompanying prospectus as well as those described in Item 1A of our annual report on Form 10-K for the fiscal year ended December 31, 2008, as amended, and in other documents that we subsequently file with the SEC that update, supplement or supersede such information for which documents are incorporated by reference into this prospectus supplement, see Where You Can Find More Information. Additional risks not presently known to us or which we consider immaterial based on information currently available to us may also materially adversely affect us. If any of the events anticipated by the risks described herein occur, our business, cash flow, results of operations and financial condition could be adversely affected which could result in a decline in the market price of our common stock, causing you to lose all or part of your investment.

Risks Related to this Offering and Ownership of our Common Stock

The market price for our common stock may be volatile.

The trading price of our common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include, in addition to the risk factors incorporated by reference herein, our quarterly operating results or the operating results of other companies in our industry, announcements by us or our competitors of acquisitions, new products, product improvements, commercial relationships, intellectual property, legal, regulatory or other business developments and changes in financial estimates or recommendations by stock market analysts regarding us or our competitors. In addition, the stock market in general, and the market for companies based in China in particular, has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated or disproportionate to their operating performance. These broad market fluctuations may have a material adverse effect on our stock price, regardless of our operating results. Further, the market for our common stock is limited and we cannot assure you that a larger market will ever be developed or maintained. We cannot predict the effect that this offering listing will have on the volume or trading price of our common stock. We cannot provide assurance that the market price of our common stock will not fall below the public offering price or that, following the offering, a stockholder will be able to sell shares acquired in this offering at a price equal to or greater than the offering price. Market fluctuations and volatility, as well as general economic, market and political conditions, could reduce our market price. As a result, these factors may make it more difficult or impossible for you to sell our common stock for a positive return on your investment.

Our quarterly results may be volatile.

Our operating results have varied on a quarterly basis during our operating history and are likely to fluctuate significantly in the future. Many factors, including the risk factors incorporated by reference herein, could cause our revenues and operating results to vary significantly in the future. Many of these factors are outside of our control. Accordingly, we believe that quarter-to-quarter comparisons of our operating results are not necessarily meaningful. Investors should not rely on the results of one quarter as an indication of our future performance. If our results of operations in any quarter do not meet analysts' expectations, our stock price could materially decrease.

Future sales of our stock could depress the market price of our common stock.

Future sales of shares of our common stock could adversely affect the prevailing market price of our stock. If our significant stockholders sell a large number of shares, or if we issue a large number of shares, the market price of our stock could significantly decline. Moreover, the perception in the public market that stockholders might sell shares of our stock could depress the market for our shares.

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Purchasers in this offering will experience immediate and substantial dilution in net tangible book value.

The assumed public offering price will be substantially higher than the net tangible book value per share of our outstanding shares of common stock. As a result, investors purchasing shares of our common stock in this offering will incur immediate dilution of \$6.40 per share, based on the public offering price of \$9.00 per share and our tangible net book value per share as of June 30, 2009. Investors purchasing shares of our common stock in this offering will pay a price per share that substantially exceeds the book value of our assets after subtracting our liabilities.

Our management has broad discretion as to the use of the net proceeds from this offering and may allocate the net proceeds of this offering in ways that you or other stockholders may not approve.

We have not determined the specific amounts we plan to spend on any of the uses described in *Use of Proceeds* or the timing of these expenditures. Failure by our management to apply these funds effectively could adversely affect our ability to maintain and expand our business. In the event management does not apply these funds effectively, your investment in our common stock may not result in a favorable return.

Our principal stockholder has the ability to exert significant control in matters requiring a stockholder vote and could delay, deter or prevent a change of control in our company.

As of June 30, 2009, Mr. Jun Wang, our Chief Executive Officer and our largest stockholder, beneficially owned more than 14.1% of our outstanding shares. Following completion of this offering, Mr. Wang will beneficially own approximately 10.8% of our outstanding shares (10.5% if the underwriters' over-allotment option is exercised in full). Mr. Wang possesses significant influence over us, giving him the ability, among other things, to effectively control the election of all or a majority of the Board of Directors and to approve significant corporate transactions. Such stock ownership and control may also have the effect of delaying or preventing a future change in control, impeding a merger, consolidation, takeover or other business combination, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company. Without the consent of Mr. Wang, we could be prevented from entering into potentially beneficial transactions if they conflict with our major stockholder's interests. The interests of this stockholder may differ from the interests of our other stockholders.

We have provisions in our articles of incorporation that substantially eliminate the personal liability of members of our board of directors for violations of their fiduciary duty of care as a director and that allow us to indemnify our officers and directors. This could make it very difficult for you to bring any legal actions against our directors for such violations or could require us to pay any amounts incurred by our directors in any such actions.

Pursuant to our articles of incorporation, members of our board of directors will have no liability for violations of their fiduciary duty of care as a director, except in limited circumstances. This means that you may be unable to prevail in a legal action against our directors even if you believe they have breached their fiduciary duty of care. In addition, our certificate of incorporation allows us to indemnify our directors from and against any and all expenses or liabilities arising from or in connection with their serving in such capacities with us. This means that if you were able to enforce an action against our directors or officers, in all likelihood we would be required to pay any expenses they incurred in defending the lawsuit and any judgment or settlement they otherwise would be required to pay.

Risks Related to Our Business

Our relationship with Sondex has substantially contributed to our business and its growth.

We are the sole authorized dealer of Sondex PHE plates in northern China. Sondex is one of the world's leading PHE and PHE plate manufacturers. We currently sell PHEs under our own Taiyu brand or upon demand under the Sondex brand, and our PHE Units are sold under our own Taiyu brand only. We believe our

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ability to provide Sondex-branded PHEs has contributed to our reputation for high quality products. Prior to our acquisition of Siping Beifang, we sourced all of our PHE plates, important raw elements used in both PHEs and PHE Units, from Sondex. However, our recent acquisition of the plant and machinery and land use rights Siping Beifang, along with our internal R&D efforts, now enable us to produce our own plates for our heat exchangers, which we believe will significantly reduce our reliance on Sondex-supplied plates. We cannot assure you that our products will be as well-received in the marketplace or that we will be able to produce sufficient quantities to meet demand. If our relationship with Sondex were to terminate, we would be required to either manufacture plates ourselves and/or procure plates from other third-party sources, of which we believe there are several alternate suppliers that meet our volume and quality standards. Currently we cannot guarantee our ability to manufacture sufficient plates or that we will be able to secure supply of plates from third-party sources on acceptable terms and in a timely fashion. Accordingly, termination of our Sondex relationship may present risks to our business, revenues and operations until we secure alternate and comparable sources of supply.

The markets we serve are subject to seasonality and cyclical demand, which could harm our business and make it difficult to project long-term performance.

Demand for our products depends in large part upon the level of capital and maintenance expenditures of our customers and the end users. These expenditures have historically been cyclical in nature and vulnerable to economic downturns. Decreased capital and maintenance spending by our customers could have a material adverse effect on the demand for our products and our business, financial condition and results of operations. In particular, an economic slowdown in the domestic economy may result in reduced orders for PHEs from the steel processing and petrochemical sectors and lower orders for PHE Units from the HVAC sector. To date, the Company has not been adversely affected by these trends and given the current demand visibility we do not currently foresee weakening in the demand for our products in the next year. However, the historically cyclical nature of the demand for our products limits our ability to make accurate long-term predictions about our performance. Changing world economic and political conditions may also reduce the willingness of our customers and prospective customers to purchase our products and services. The seasonality of our business results in significant operational challenges to our production and inventory control functions.

We derive a substantial part of our revenues from several major customers. If we lose any of these customers or they reduce the amount of business they do with us, our revenues may be seriously affected.

Our ten largest customers accounted for 32% of our revenues for the fiscal year ended December 31, 2008. Our largest customer accounted for 6% of our revenues in the fiscal year ended December 31, 2008. These customers may not maintain the same volume of business with us in the future. If we lose any of these customers or they reduce the amount of business they do with us, our revenues and profitability may be seriously affected.

Our accounts receivables remain outstanding for a significant period of time which has a negative impact on our cash flow and liquidity.

Our agreements with our customers generally provide that 30% of the purchase price is due upon the placement of an order, 30% is due upon delivery and 30% is due upon installation and acceptance of the equipment after customer testing. As a common practice in the heating manufacturing business in China, payment of the final 10% of the purchase price is due no later than the termination date of the standard warranty period which ranges from 3 to 24 months from the acceptance date. We may experience payment delays from time to time which range from 1 month to 3 months from the due date. While these payment delays are very common in the heating manufacturing industry in China and historically our collections have been reasonably assured, such delays cause capital to be tied up in inventories which may result in pressure on our cash flows and liquidity. In 2008, we had accounts receivable turnover of 3.6, with days sales outstanding of 136 and inventory turnover of 3.1 on an annualized basis. For the six months ended June 30, 2009, we had accounts receivable turnover of 3.16, with days sales outstanding of 112 and inventory turnover of 3.32 on an annualized basis.

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We acquire most of the components for the manufacture of our products from a limited number of suppliers.

We acquire most of the components for the manufacture of our products from a limited number of suppliers. In order for us to have our products manufactured, these components must be available when needed, at the right level of quality, and at the right price. If we are unable to so obtain these components, we would experience delays in manufacturing our products and our financial results could be adversely affected. Suppliers of some of these components require us to place orders with significant lead-time to assure supply in accordance with our requirements. Certain of these suppliers are currently the sole source of one or more components upon which we are dependent and alternative sources would not be available for those components unless we were to redesign our products. Other components could be obtained from alternate suppliers without redesign, but only at higher prices than we currently pay or for delivery later than required by our production schedule. We maintain a relatively small inventory of component parts for resale and our parts services business would suffer if the supply of replacement parts was reduced or terminated by our suppliers. If suppliers are not able to provide these critical components on the dates and at the prices scheduled, we may not be able to promptly and cost-effectively manufacture our products to meet customer orders which could harm our credibility and the market acceptance and sales of our products. Increased costs associated with supplied materials or components could increase our costs and reduce our profitability if we are unable to pass these cost increases on to our customers.

We are a major purchaser of certain goods and raw materials that we use in the manufacturing process of our products, and price changes for the commodities we depend on may adversely affect our profitability.

Our profitability generally depends upon the margin between the cost to us of certain goods used in the manufacturing process, such as plates, pumps, water tanks, sensors, controlling systems and other raw materials as well as our fabrication costs associated with converting such goods and raw materials compared to the selling price of our products, and the overall supply of raw materials. It is our intention to base the selling prices of our products upon the associated raw materials costs to us. However, we may not be able to pass all increases in raw material costs and ancillary acquisition costs associated with taking possession of the raw materials through to our customers. Although we are currently able to obtain adequate supplies of raw materials, it is impossible to predict future availability or cost. With the rapid growth of China's economy, the demand for certain raw materials is great while the supply may be more limited. This may affect our ability to secure the necessary raw materials in a cost-effective manner for production of our products at the volume of purchase orders that we anticipate receiving. The inability to offset price increases of raw materials by sufficient product price increases, and our inability to obtain raw materials, would have a material adverse effect on our consolidated financial condition, results of operations and cash flows.

We may experience material disruptions to our manufacturing operations.

While we seek to operate our facilities in compliance with applicable rules and regulations and take measures to minimize the risks of disruption at our facilities, a material disruption at one of our manufacturing facilities could prevent us from meeting customer demand, reduce our sales and/or negatively impact our financial results. Any of our manufacturing facilities, or any of our machines within an otherwise operational facility, could cease operations unexpectedly due to a number of events, including:

prolonged power failures;

equipment failures;

disruptions in the transportation infrastructure including roads, bridges, railroad tracks;

fires, floods, earthquakes or other catastrophes; and

other operational problems.

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PRC regulations relating to mergers, offshore companies and Chinese stockholders, if applied to us, may limit our ability to operate our business as we see fit.

PRC regulations govern the process by which we may participate in an acquisition of assets or equity interests. Depending on the structure of the transaction, these regulations require Chinese parties to make a series of applications and supplemental applications to various government agencies. In some instances, the application process may require the presentation of economic data concerning a transaction, including appraisals of the target business and evaluations of the acquirer, which are designed to allow the government to assess the transaction. Government approvals will have expiration dates by which a transaction must be completed and reported to the government agencies. Compliance with the new regulations is likely to be more time consuming and expensive than in the past and the government can now exert more control over the combination of two businesses. Accordingly, due to PRC regulations, our ability to engage in business combination transactions in China through our Chinese subsidiaries has become significantly more complicated, time consuming and expensive, and we may not be able to negotiate transactions that are acceptable to us or sufficiently protective of our interests.

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. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time-to-time in mainland China. 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. Although we inform our personnel that such practices are illegal, we can not assure you that our employees or other agents will not engage in such conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties.

If the China Securities Regulatory Commission, or CSRC, or another PRC regulatory agency determines that its approval is required in connection with this offering, this offering may be delayed or cancelled, or we may become subject to penalties.

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the Regulation on Mergers and Acquisitions of Domestic Companies by Foreign Investors, or the M&A Rule, which became effective on September 8, 2006. The M&A Rule, among other things, has certain provisions that require offshore special purpose vehicles, or SPVs, formed for the purpose of acquiring PRC domestic companies and controlled by PRC individuals, to obtain the approval of the CSRC prior to listing their securities on an overseas stock exchange. We believe, based on the opinion of our PRC legal counsel, the Beijing Rondos Law Firm, that while the CSRC generally has jurisdiction over overseas listings of SPVs like us, CSRC's approval is not required for the offerings of our securities because our current corporate structure was established before the new regulation became effective. However, there remains some uncertainty as to how this regulation will be interpreted or implemented in the context of an overseas offering. If the CSRC or another PRC regulatory agency subsequently determines that its approval is required for our public offerings, we may face sanctions by the CSRC or another PRC regulatory agency. If this happens, these regulatory agencies may impose fines and 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 or other of our offerings into the PRC, restrict or prohibit payment or remittance of dividends by our PRC subsidiaries 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 ordinary shares. 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 before settlement and delivery of the ordinary shares being offered by us.

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We operate in the PRC through our Wholly Foreign Owned Enterprise (WFOE) status initially approved by the local office of the PRC Ministry of Commerce (MOFCOM). However, we cannot warrant that such approval procedures have been completely satisfied due to a number of reasons, including changes in laws and government interpretations. If we lose our WFOE status for any reason, our business in China may be negatively impacted.

Our operating entities in the PRC have received initial MOFCOM approval as WFOEs and there may be conditions subsequent to complete and maintain such status. We believe we have satisfied MOFCOM 's approval procedures for having obtained such status. However, MOFCOM 's approval procedures or interpretations of its approval procedures may be different from our understanding or may change. As a result, if we lose our WFOE status for any reason, there may be a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our shares.

If we fail to satisfy enlarged contribution of capital requirement at our PRC subsidiaries, our business in China will be adversely affected.

We are required to contribute RMB 53 million as additional contribution of capital to our PRC subsidiaries by July 2010. Under PRC laws, shareholders of a foreign-invested enterprise are required to contribute capital to satisfy the registered capital requirement of the foreign-invested enterprise within a period of not more than two years from the date when the foreign-invested enterprise 's license to conduct business is initially granted. The relevant PRC government agencies may grant an additional three-month grace period. If the shareholders are unable to complete the capital contribution within the grace period, the business license of the foreign-invested enterprise may be revoked by the PRC government. Further, until such contribution of capital is satisfied, the foreign-invested enterprise is not allowed to repatriate profits to its shareholders, unless otherwise approved by the State Administration for Foreign Exchange (SAFE).

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PRICE RANGE OF COMMON STOCK AND DIVIDEND POLICY

On April 22, 2008, our common stock became eligible for quotation on the OTCBB under the symbol SMHT. The following table sets forth the range of the high and low bid prices per share of our common stock for each quarter (or portion thereof) beginning on April 22, 2008 and ending on June 30, 2009 as reported by the OTC Bulletin Board for the period beginning on April 22, 2008 to January 28, 2009 and as reported on the Nasdaq Stock Market from January 29, 2009 to March 9, 2009 and on the Nasdaq Global Market thereafter. These quotations represent inter-dealer prices, without retail mark-up, markdown, or commission and may not represent actual transactions.

	High	Low
Second Quarter 2008 (April 22, 2008 - June 30, 2008)	\$ 4.60	\$ 2.00
Third Quarter 2008 (through September 30, 2008)		