

China XD Plastics Co Ltd  
Form 10-Q/A  
November 02, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q/A  
Amendment No. 1

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE  
ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

000-53131  
(Commission file number)

CHINA XD PLASTICS COMPANY LIMITED  
(Exact name of registrant as specified in its charter)

Nevada 04-3836208  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

No. 9 Dalian North Road, Haping Road Centralized Industrial Park,  
Harbin Development Zone, Heilongjiang Province, PRC 150060  
(Address of principal executive offices) (Zip Code)

86-451-84346600  
(Registrant's telephone number, including area code)

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the issuer (1) has filed

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of November 8, 2010, there were 47,628,367 issued and outstanding shares of the issuer’s common stock.

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Explanatory Note

This quarterly report on Form 10-Q is being filed as Amendment No. 1 to our quarterly Report on Form 10-Q (“Amendment No. 1”) which was originally filed on November 12, 2010 with the Securities and Exchange Commission (the “Original 10-Q”) to amend and restate our financial statements and related disclosures for the quarters ended September 30, 2010 and 2009. This amendment is filed solely with respect to the following items:

- Part I, Item 1- Condensed Consolidated Financial Statements (Unaudited)  
Notes to the Condensed Consolidated Financial Statements (Unaudited)
- Part I, Item 2- Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The restatements are related to accounting errors identified in (1) the Company’s condensed consolidated statements of cash flows and (2) calculation of basic and diluted earnings per share. An explanation of the errors and the impact on the Company’s condensed consolidated financial statements is contained in Note 20 to the condensed consolidated financial statements contained in Part I, Item 1 of this report. The following is a brief summary of the accounting errors:

I. Errors in the Condensed Consolidated Statements of Cash Flows:

- a) The Company did not consider the impact of the unpaid amounts relating to property, plant and equipment in preparing the condensed consolidated statements of cash flows for the nine months ended September 30, 2010 and 2009;
- b) The Company settled purchase obligations due to its equipment vendors using bank acceptance notes the Company received from its customers. The Company reported such transactions as both operating cash inflows and investing cash outflows, instead of non-cash transactions for the nine months ended September 30, 2010 and 2009;
- c) In 2009, the Company settled a related party loan using bank acceptance notes the Company received from its customers. The Company reported such transaction as both operating cash inflows and financing cash outflows, instead of non-cash transactions for the nine months ended September 30, 2009.

As a result our cash flows provided by operating activities were restated by decreasing \$5,322,903 and \$8,341,759 for the nine months ended September 30, 2010 and 2009, respectively; our cash flows used in investing activities were restated by decreasing \$5,322,903 and \$1,373,628 for the nine months ended September 30, 2010 and 2009, respectively and our cash flows used in financing were restated by decreasing \$6,968,131 for the nine months ended September 30, 2009. Furthermore, we included additional disclosure supplement to the condensed consolidated statements of cash flows. Specifically, accrual for purchase of property and equipment were \$1,469 and \$10,245 as at September 30, 2010 and 2009, respectively; settlement of equipment purchase through bank acceptance notes were \$5,876,649 and \$1,461,814 for the nine months ended September 30, 2010 and 2009, respectively, and settlement of a related party loan using bank acceptance notes was \$6,968,131 for the nine months ended September 30, 2009.

The adjustments had no effect on total assets, total liabilities, net income or cash balances as previously reported.

II. Errors in Earnings Per Share (“EPS”) Calculations:

- (a) The Company did not apply the two-class method in the calculation of diluted earnings per share (“EPS”) in the financial statements for the three and nine months ended September 30, 2010 and 2009;
- (b) The Company identified a mathematical error in the computation of diluted EPS in the financial statements for the three and nine months ended September 30, 2010, in which the Company did not deduct the changes in fair values of warrants from net income attributable to common stockholders in the calculation of diluted EPS.

As a result, the basic EPS was restated by decreasing \$0.02 for the nine months ended September 30, 2010 and the diluted EPS was restated by decreasing \$0.01 and \$0.04 for the three months and nine months ended September 30, 2010, respectively. The basic EPS was restated by decreasing \$0.02 for the nine months ended September 30, 2009.

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## CHINA XD PLASTICS COMPANY LIMITED

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

CHINA XD PLASTICS COMPANY LIMITED  
CONDENSED CONSOLIDATED BALANCE SHEETS

| ASSETS   | Note | September 30, 2010    | December 31,<br>2009 |
|--|------|-----------------------|----------------------|
| Current assets:  |      |                       |                      |
| Cash and cash equivalents  |      | \$ 15,475,824         | \$ 6,850,784         |
| Notes receivable   |      | 333,015               | 407,487              |
| Accounts receivable - net of allowance for doubtful receivables of \$194,931 and \$166,095, respectively | 3    | 15,631,195            | 8,558,172            |
| Prepaid expenses and other receivables   |      | 466,125               | 253,172              |
| Inventories  | 4    | 27,665,735            | 18,371,485           |
| Due from related parties   | 8    | 2,705                 | -                    |
| Advances to employees  | 5    | 223,255               | 512,745              |
| Advances to suppliers  |      | 27,212,902            | 20,245,861           |
| Taxes receivable   |      | 644,330               | 406,755              |
| <b>Total current assets</b>  |      | <b>87,655,086</b>     | <b>55,606,461</b>    |
| Property, plant and equipment, net   | 6    | 35,302,480            | 31,083,389           |
| Other assets:  |      |                       |                      |
| Intangible assets, net   | 7    | 242,593               | 241,945              |
| <b>Total assets</b>  |      | <b>\$ 123,200,159</b> | <b>\$ 86,931,795</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |      |                       |                      |
| Current liabilities:   |      |                       |                      |
| Short term loans   | 9    | \$ 20,923,128         | \$ 21,678,565        |
| Accounts payable   |      | 1,473,126             | 1,258,459            |
| Other payables   | 17   | 3,159,428             | 714,504              |
| Accrued expenses   |      | 213,519               | 648,358              |
| Taxes payable  |      | 63,317                | 4,134                |
| Due to an employee   |      | 360,000               | -                    |
| Due to related parties   | 8    | 2,030,672             | 148,397              |
| Deferred revenue   |      | 155,354               | 300,296              |
| Dividends payable  |      | 792,060               | 77,396               |
| <b>Total current liabilities</b>   |      | <b>29,170,604</b>     | <b>24,830,109</b>    |
| Other liabilities  |      |                       |                      |

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|   |    |                |               |
|---|----|----------------|---------------|
| Common stock warrant purchase liabilities   | 11 | 6,696,224      | 7,892,513     |
| Embedded conversion feature liabilities   | 11 | 2,006          | 18,798,059    |
| Total other liabilities   |    | 6,698,230      | 26,690,572    |
| Total liabilities   |    | 35,868,834     | 51,520,681    |
| Series C convertible redeemable preferred stock: 15,186 and 15,188 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively                         |    |                |               |
|   | 11 | 1,829          | 13,891,477    |
| Commitments and contingencies   | 16 |                |               |
| Stockholders' equity  |    |                |               |
| Series B Preferred Stock, \$0.0001 par value, 50,000,000 shares authorized, 1,000,000 shares issued and outstanding as of September 30, 2010 and December 31, 2009                    |    |                |               |
|   | 13 | 100            | 100           |
| Common Stock, \$0.0001 par value, 500,000,000 shares authorized, 44,295,033 and 40,867,050 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively |    |                |               |
|   | 13 | 4,429          | 4,087         |
| Additional paid-in-capital  |    | 59,610,876     | 15,360,949    |
| Retained earnings   |    | 21,903,681     | 2,160,621     |
| Statutory surplus reserve fund  |    | 2,471,007      | 2,471,007     |
| Accumulated other comprehensive income  |    | 3,339,403      | 1,522,873     |
| Total stockholders' equity  |    | 87,329,496     | 21,519,637    |
| Total liabilities and stockholders' equity  |    | \$ 123,200,159 | \$ 86,931,795 |

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

CHINA XD PLASTICS COMPANY LIMITED  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME

|  | Note | For the Nine Months Ended<br>September 30, |                                    | For the Three Months Ended<br>September 30, |               |
|--|------|--|------------------------------------|---|---------------|
|  |      | 2010                                       | 2009                               | 2010  | 2009          |
|  |      | (Restated -<br>Note 20)                    | (Restated -<br>Notes 18 and<br>20) | (Restated -<br>Note 20)                     |               |
| Sales  |      | \$ 177,392,985                             | \$ 94,498,615                      | \$ 65,345,883                               | \$ 36,194,459 |
| Cost of sales  |      | (134,419,371)                              | (73,656,568)                       | (49,073,589)                                | (27,777,237)  |
| Gross profit   |      | 42,973,614                                 | 20,842,047                         | 16,272,294                                  | 8,417,222     |
| Operating expenses   |      |  |                                    |   |               |
| Research and development expenses                          |      | 5,171,324                                  | 868,252                            | 1,827,136                                   | 370,279       |
| Selling expenses   |      | 316,493                                    | 224,261                            | 103,288                                     | 118,018       |
| General and administrative expenses                        |      | 18,445,371                                 | 8,833,438                          | 1,741,083                                   | 3,606,997     |
| Total operating expenses                                   |      | 23,933,188                                 | 9,925,951                          | 3,671,507                                   | 4,095,294     |
| Operating income   |      | 19,040,426                                 | 10,916,096                         | 12,600,787                                  | 4,321,928     |
| Other income (expenses)                                    |      |  |                                    |   |               |
| Interest income (expenses)                                 |      | (993,817 )                                 | (1,033,183 )                       | (310,514 )                                  | (340,464 )    |
| Other income   |      | 47,951                                     | 62,949                             | 2,340                                       | 407           |
| Other expense  |      | (17,549 )                                  | (10,937 )                          | (51 )                                       | (1,052 )      |
| Changes in fair value of warrants and embedded derivatives | 11   | 4,496,950                                  | -                                  | 88,064                                      | -             |
| Total other income (expense)                               |      | 3,533,535                                  | (981,171 )                         | (220,161 )                                  | (341,109 )    |
| Income before income taxes                                 |      | 22,573,961                                 | 9,934,925                          | 12,380,626                                  | 3,980,819     |
| Provision for income taxes                                 | 10   | (184,900 )                                 | (30,641 )                          | (117,549 )                                  | (24,179 )     |
| Net income   |      | \$ 22,389,061                              | \$ 9,904,284                       | \$ 12,263,077                               | \$ 3,956,640  |
| Other comprehensive income                                 |      |  |                                    |   |               |
| Foreign currency translation adjustment                    |      | 1,816,530                                  | (46,606 )                          | 1,271,020                                   | (19,210 )     |
| Comprehensive income                                       |      | \$ 24,205,591                              | \$ 9,857,678                       | \$ 13,534,097                               | \$ 3,937,430  |



| Basic and diluted earnings per common share |    |         |         |         |         |
|---|----|---------|---------|---------|---------|
| Basic                                       | 15 | \$ 0.44 | \$ 0.40 | \$ 0.28 | \$ 0.10 |
| Diluted                                     | 15 | \$ 0.41 | \$ 0.25 | \$ 0.27 | \$ 0.10 |

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

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## CHINA XD PLASTICS COMPANY LIMITED

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | For the Nine Months ended<br>September 30, |  |
|---|--|--|
|   | 2010<br>(Restated -<br>Note 20)            | 2009<br>(Restated –Notes<br>18 and 20) |
| Cash flows from operating activities  |  |  |
| Net income  | 22,389,061                                 | \$ 9,904,284                           |
| Adjustments to reconcile net income to net cash provided by<br>(used in)operating activities: |  |  |
| Depreciation and amortization   | 2,482,144                                  | 1,457,983                              |
| Stock-based compensation expense  | 14,730,213                                 | 6,256,818                              |
| Change in fair value of warrants and derivative liabilities                                   | (4,496,950 )                               | -                                      |
| Loss (gain) on disposals of property, plant and equipment                                     | (24,278 )                                  | 45,342                                 |
| Changes in assets and liabilities:  |  |  |
| (Increase) decrease in -  |  |  |
| Restricted cash   | -  | 3,659,063                              |
| Notes receivables   | (5,795,307 )                               | (8,245,792 )                           |
| Accounts receivable and other receivables   | (6,975,637 )                               | (995,004 )                             |
| Prepaid expenses  | 22,654                                     | (34,796 )                              |
| Inventories   | (8,769,909 )                               | (2,842,260 )                           |
| Advances to employees   | 253,518                                    | (341,056 )                             |
| Advances to suppliers   | (6,444,761 )                               | 3,287,927                              |
| Taxes receivable  | (225,426 )                                 | (223,483 )                             |
| Due from related parties  | -  | (50,389 )                              |
| Deferred charge   | -  | 377,528                                |
| Increase (decrease) in -  |  |  |
| Accounts payable and other payables   | 3,128,867                                  | 642,993                                |
| Due to an employee  | 360,000                                    | -                                      |
| Accrued expenses  | (439,738 )                                 | (515,740 )                             |
| Tax payable   | 58,109                                     | (1,536 )                               |
| Deferred revenue  | (148,476 )                                 | (2,528,120 )                           |
| Net cash provided by operating activities   | 10,104,084                                 | 9,853,762                              |
| Cash flows from investing activities  |  |  |
| Purchase of property, plant and equipment   | (983,753 )                                 | (468,678 )                             |
| Proceeds from sales of property, plant and equipment  | 324,924                                    | -                                      |
| Net cash used in investing activities   | (658,829 )                                 | (468,678 )                             |
| Cash flows from financing activities  |  |  |
| Dividends paid  | (1,796,337 )                               | -                                      |
| Repayment of short term loans   | (1,175,328 )                               | (292,725 )                             |
| Repayment of bank acceptance notes payable  | -  | (8,049,938 )                           |
| Repayment to related parties  | (2,666 )                                   | (360,552 )                             |
| Proceeds from related parties   | 1,879,320                                  | 562,511                                |

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|  |               |              |
|--|---------------|--------------|
| Net cash used in financing activities                              | (1,095,011 )  | (8,140,704 ) |
| Effect of exchange rate changes on cash and cash equivalents       | 274,796       | (48,035 )    |
| Net increase in cash and cash equivalents                          | 8,625,040     | 1,196,345    |
| Cash and cash equivalents, beginning of period                     | 6,850,784     | 3,869,035    |
| Cash and cash equivalents, end of period                           | \$ 15,475,824 | \$ 5,065,380 |
| Supplemental disclosures of cash flow information:                 |               |              |
| Interest paid  | \$ 950,483    | \$ 1,033,183 |
| Income taxes paid  | \$ 67,540     | \$ -         |
| Non-cash investing and financing activities:                       |               |              |
| Embedded conversion feature reclassified to equity upon conversion | \$ 15,495,392 | \$ -         |
| Common stock issued for preferred stock                            | \$ 13,889,648 | \$ -         |
| Warrants issued for consulting service                             | \$ -          | \$ 46,260    |
| Stock options granted to a director                                | \$ 13,355,832 | \$ 3,065,388 |
| Common stock options/restricted shares issued for services         | \$ 1,374,381  | \$ 3,145,170 |
| Accrual for purchase of property and equipment                     | \$ 1,469      | \$ 10,245    |
| Settlement of equipment purchases using bank acceptance notes      | \$ 5,876,649  | \$ 1,461,814 |
| Settlement of a related party loan using bank acceptance notes     | \$ -          | \$ 6,968,131 |

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

CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

Note 1. ORGANIZATION AND BASIS OF PRESENTATION

China XD Plastics Company Limited (“China XD Plastics”), formerly known as NB Telecom, Inc. (“NB Telecom”), was originally incorporated as NB Payphones Ltd. under the laws of the state of Pennsylvania on November 16, 1999. On December 27, 2005, we migrated our state of organization to the state of Nevada and effective March 23, 2006, the name was changed to NB Telecom.

On December 24, 2008, NB Telecom acquired all of the outstanding capital stock of Favor Sea Limited (“Favor Sea (BVI)”), a British Virgin Islands corporation, whose assets, held through its subsidiaries, are 100% of the registered capital of Harbin Xinda Macromolecule Material Co., Ltd. (“Harbin Xinda”), a limited liability company established under the laws of the People’s Republic of China (“China” or “PRC”) and Harbin Xinda’s wholly-owned subsidiary, Harbin Xinda Macromolecule Material Research Institute (the “Research Institute”). Harbin Xinda is engaged in the development, manufacture and marketing of modified plastics, primarily for use in the automotive industry. Harbin Xinda’s offices and manufacturing facilities are located in China.

- In connection with the acquisition, the following transactions took place:

China XD Plastics issued 10 shares of the common stock which constituted no more than 10% ownership interest in China XD Plastics and 1,000,000 shares of convertible Series A preferred stock of China XD Plastics to the shareholders of Favor Sea (BVI), and also 1,000,000 shares of Series B preferred stock to XD Engineering Plastics Company Limited (“XD Engineering”), a British Virgin Islands corporation, the principal shareholder of Favor Sea (BVI), in exchange for all of the outstanding stock of Favor Sea (BVI) (the “Share Exchange” or “Merger”). The 10 shares of the common stock were converted into approximately 50,367,778 shares of the common stock of NB Telecom prior to and approximately 405,802 post a reverse stock split of 124.1 for 1 pursuant to Nevada Revised Statutes Section 78.207 for both the total number of authorized shares of common stock and the total number of issued and outstanding shares of common stock (“Reverse Split”), and the 1,000,000 shares of convertible Series A preferred stock of NB Telecom shall convert approximately at a rate of 1:38.2 into 38,194,072 shares of the common stock of NB Telecom after the completion of the Merger so that eventually the shareholders of Favor Sea (BVI) own approximately 99% of the common stock of NB Telecom.

- The record date for the Reverse Split was set for December 31, 2008. The record holders of NB Telecom’s common stock on the date of December 31, 2008 were subject to a 124.1:1 reverse split with fractional shares to be rounded up to one hundred round lot, with the round-up shares to be deducted from certain designated shareholders by NB Telecom.

CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

Note 1. ORGANIZATION AND BASIS OF PRESENTATION (Continued)

- In connection with the acquisition of Favor Sea (BVI), former officers and directors of NB Telecom resigned and executive officers of Favor Sea (BVI) were appointed as China XD Plastic's new officers and directors.
  - As part of the Merger, the name of the company was changed from NB Telecom to China XD Plastics.

As a result of these transactions, the shareholders of Favor Sea (BVI) owns majority of the equity in China XD Plastics.

The acquisition was accounted for as a reverse merger under the purchase method of accounting since there had been a change of control. Accordingly, Favor Sea (BVI) and its subsidiaries are treated as the continuing entities for accounting purposes.

Favor Sea (BVI) was incorporated under the laws of the British Virgin Islands on May 2, 2008.

On August 11, 2008, Favor Sea (BVI) acquired a 100% interest in Hong Kong Engineering Plastics Company Limited ("HK Engineering Plastics"), a limited liability company incorporated under the laws of the Hong Kong Special Administrative Region on May 27, 2008.

Favor Sea (US) Inc. ("Favor Sea (US)"), wholly owned by Favor Sea (BVI), was incorporated in the state of New York in the U.S. on December 15, 2008.

HK Engineering Plastics, in turn, owns 100% interest of Harbin Xinda, a company established in the PRC on September 23, 2004.

China XD Plastics, through its indirectly owned subsidiary, Harbin Xinda, is primarily engaged in the business of research and development, manufacture, and distribution of modified and engineering plastic pellets used in automotive parts through its manufacturing facility and its wholly owned research laboratory, the Research Institute, a separate entity established in the PRC on November 9, 2007.

In June 2010, China XD Plastics, through its indirectly owned subsidiary, Harbin Xinda, invested RMB 20 million (approximately US\$2.9 million) to establish a new subsidiary under the laws of the PRC, Harbin Xinda Macromolecule Material Engineering Research Center Company Limited (the "New Research Center").

CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements for the nine months ended September 30, 2010 and 2009 include the accounts of China XD Plastics, Favor Sea (BVI), Favor Sea (US), HK Engineering Plastics, Harbin Xinda and the Research Institute. The consolidated financial statements for the nine months ended September 30, 2010 also include the accounts of the New Research Center. They are collectively referred to as the "Company". The Company's consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP"). All significant inter-company balances and transactions are eliminated in consolidation.

Use of Estimates

In preparing the financial statements in conformity with US GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Significant estimates, required by management, include share-based compensation and fair value of derivatives. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of September 30, 2010 and December 31, 2009, the Company did not have any cash equivalents.

Accounts Receivable

Accounts receivable consist primarily of receivables resulting from sales of products, and are stated at net realizable value.

Allowance for Doubtful Receivables

The Company recognizes an allowance for doubtful receivables to ensure accounts and other receivables are not overstated due to uncollectability. Allowance for doubtful receivables is maintained for all customers based on a variety of factors, including the length of time the receivables are past due, significant one-time events and historical experience. An additional allowance for individual accounts is recorded when the Company becomes aware of a customer's or other debtor's inability to meet its financial obligation, such as in the case of bankruptcy filings or deterioration in the customer's or other debtor's operating results or financial position. If circumstances related to customers or debtors change, estimates of the recoverability of receivables would be further adjusted (See Note 3).



CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventories

Inventories comprise raw materials, packing materials, work in progress and finished goods. Inventories are valued at the lower of cost or market with cost determined by the weighted average method. Management periodically compares the cost of inventories with the market value and an allowance is made to write down the inventories to their respective market values, if lower than cost. No allowance for inventories was considered necessary for the nine months ended September 30, 2010 and 2009.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and locations for its intended use. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets.

Management estimates that property, plant and equipment have a 5% residual value. The estimated useful lives are as follows:

|                                      |            |
|--------------------------------------|------------|
| Plant and buildings                  | 39 years   |
| Machinery, equipment and automobiles | 5-10 years |

Expenditure for maintenance and repairs is charged to expense as incurred. Additions, renewals and betterments are capitalized.

The gain or loss on disposal of property, plant and equipment is the difference between the net sales proceeds and the carrying amount of the relevant assets, and, if any, is recognized in the statement of income and other comprehensive income.

Advances to Suppliers

Advances to suppliers represent payments made and recorded in advance for goods and services. The Company makes advance payments to raw materials suppliers. In order to maintain a long-term relationship with the suppliers, the Company frequently makes advance payments from one and a half month to three months ahead. The advances to suppliers were \$27,212,902 and \$20,245,861 as of September 30, 2010 and December 31, 2009, respectively.

Impairment of Long-lived Assets

Long-lived assets, which include property, plant and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the assets. If the carrying amounts of assets exceed their estimated undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amounts of the assets exceed the fair value of the assets. Fair value is generally determined using the asset's expected future discounted cash flows or market value, if readily determinable. No impairment loss was



recorded for the nine months ended September 30, 2010 and 2009, respectively.

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CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible Asset

Intangible asset consists of land use right which is stated at cost less amortization. Amortization is computed using the straight-line method, based on the period over which the right is granted by the relevant authorities in Heilongjiang Province, PRC.

Stock Based Compensation

The Company accounts for stock-based compensation arrangements using the fair value method in accordance with Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) 718 “Compensation-Stock Compensation”. FASB ASC 718 requires that the fair value of share awards issued, modified, repurchased or cancelled after implementation, under share-based payment arrangements, is measured as of the date the award is issued, modified, repurchased or cancelled. The resulting cost is then recognized in the statement of income and comprehensive income over the service period.

The Company estimates fair value of restricted stock based on the number of shares granted and the quoted price of the Company’s common stock on the date of grant.

The fair value of stock options and warrants is estimated using the Black-Scholes option-pricing model. The Company’s expected volatility assumption is based on similar public entities for which share and option price information is available, and the historical volatilities of those public entities’ share prices are considered in calculating the expected volatility appropriate to the Company. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The Company measures compensation expense for its non-employee stock-based compensation under FASB Emerging Issues Task Force (EITF) Issue No. 96-18, “Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services”, which is now codified as FASB ASC 718.

The fair value of the stock issued is used to measure the transaction, as this is more reliable than the fair value of the services received. Fair value is measured as the value of the Company’s common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty’s performance is complete. The fair value of the equity instrument is charged directly to compensation expense.

CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Based Compensation (Continued)

Stock compensation expense recognized is based on awards expected to vest. FASB ASC 718 requires forfeitures to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates. The current options outstanding were only issued to founders and senior executives of the Company, which have very low turnover; therefore, there are no estimated forfeitures for these options.

Derivative Financial Instruments

Derivative financial instruments are accounted for under FASB ASC 815 "Derivatives and Hedging". Under FASB ASC 815, all derivative instruments are recorded on the balance sheet as assets or liabilities and measured at fair value. Changes in the fair value of derivative instruments are recorded in current earnings.

Income Taxes

The Company accounts for income taxes under FASB ASC 740 "Income Taxes". Under FASB ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company reviewed the differences between the tax bases under PRC tax laws and financial reporting under US GAAP, and no material differences were found.

FASB ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and it prescribes a recognition threshold and measurement attributable for the financial statements recognition and measurement of a tax position taken or expected to be taken in a tax return. FASB ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. Interest and penalties from tax assessments, if any, are included in general and administrative expenses in the consolidated statement of income and comprehensive income.

The Company recognizes that virtually all tax positions in the PRC are not free of some degree of uncertainty due to tax law and policy changes by the PRC government. However, the Company cannot reasonably quantify political risk factors and thus must depend on guidance issued by current PRC government officials.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of September 30, 2010 is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax benefits as of September 30, 2010, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company's results of operations, financial condition or cash flows.

Under current PRC tax laws, 10% withholding tax is imposed in respect to distributions paid to foreign owners. As the subsidiaries in the PRC have no intention to pay dividends in the foreseeable future, no withholding tax on undistributed earnings has been accrued as of September 30, 2010.

Revenue Recognition

The Company's revenue recognition policies are in compliance with Staff Accounting Bulletin No. 101, as revised by No.104, issued by the United States Securities and Exchange Commission, or U.S SEC, which is now codified as FASB ASC 605. In accordance with FASB ASC 605, revenues are recognized when the four following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) the delivery is completed, (iii) the fees are fixed or determinable, and (iv) collectability is reasonably assured.

Revenue from sales of products is recognized when the title is passed to customers upon delivery and when collectability is reasonably assured. The Company does not provide its customers with the right of return (except for quality). All sales are based on firm customer orders with fixed terms and conditions, which generally cannot be modified.

Research and Development Expenses

Research and development expenses are costs associated with developing the Company's intellectual property. Research and development costs are expensed as incurred. The costs of equipment that are acquired or constructed for research and development activities and have alternative future uses are classified as plant and equipment and depreciated over their estimated useful lives. The research and development expenses for the nine months ended September 30, 2010 and 2009 were \$5,171,324 and \$868,252, respectively. The research and development expense for the three months ended September 30, 2010 and 2009 was \$1,827,136 and \$370,279, respectively.

CHINA XD PLASTICS COMPANY LIMITED  
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Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value of Financial Instruments

FASB ASC 825 “Financial Instruments” requires disclosing fair value to the extent practicable for financial instruments that are recognized or unrecognized in the balance sheet. The fair value of the financial instruments disclosed herein is not necessarily representative of the amount that could be realized or settled, nor does the fair value amount consider the tax consequences of realization or settlement.

The carrying amounts of certain financial instruments, including cash and cash equivalents, accounts receivable, notes and other receivables, accounts payable, accrued expenses, notes payable and other payables approximate fair value due to the short-term nature of these items. The carrying amounts of short-term loans from bank approximate the fair value based on the Company's expected borrowing rate for debt with similar remaining maturities and comparable risk.

Fair Value Measurement

FASB ASC 820 “Fair Value Measurements and Disclosures” introduces a framework for measuring fair value and expands required disclosure about fair value measurements of assets and liabilities. FASB ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

There are three levels of inputs that may be used to measure fair value:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company uses an option-pricing model that incorporates the Company's stock price and risk-free interest rate as well as assumptions regarding a number of highly complex and subjective variables, which includes but not limits to the Company's expected stock price volatility over the term of the derivative liabilities.



CHINA XD PLASTICS COMPANY LIMITED  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets and liabilities measured at fair value on a recurring basis are summarized below:

| Description                               | Total<br>US\$    | Fair Value Measurement as of<br>September 30, 2010 |                  |                 |
|---|------------------|--|------------------|-----------------|
|   |                  | Level 1<br>US\$                                    | Level 2<br>US\$  | Level 3<br>US\$ |
| Common stock warrant purchase liabilities | 6,696,224        | -  | 6,696,224        | -               |
| Embedded conversion feature liabilities   | 2,006            | -  | 2,006            | -               |
| <b>Total</b>                              | <b>6,698,230</b> | <b>-</b>   | <b>6,698,230</b> | <b>-</b>        |

Earnings per Share

The Company computes earnings per share ("EPS") in accordance with FASB ASC 260. FASB ASC 260 requires companies with complex capital structures to present basic and diluted EPS. Basic EPS is measured as net income divided by the weighted average common shares outstanding for the year.

Diluted EPS is similar to basic EPS but presents the dilutive effect on a per share basis of potential common shares (e.g., convertible securities, options and warrants) as if they had been converted at the beginning of the periods presented, or issuance date, if later. Potential common shares that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS.

Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes unrealized gains or losses resulting from currency translations of foreign subsidiaries.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash and accounts receivable. The Company does not require collateral or other security to support these receivables. The Company conducts periodic reviews of its customers' financial condition and customer payment practices to minimize collection risk on accounts receivable. As of September 30, 2010 and December 31, 2009, the Company had credit risk exposure of uninsured cash in banks of approximately \$15,475,824 and \$6,850,784, respectively.

Risks and Uncertainties

The Company's operations in the PRC are subject to special consideration and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, political, economic and legal environment and foreign currency exchange. The Company's results may be adversely affected by changes in the political and social conditions in the PRC, and by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion, remittances abroad, and rates and methods of taxation, among other things.





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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign Currency Translation

The functional currency of the Company is Renminbi, and its reporting currency is U.S. dollars. In accordance with FASB ASC 830 "Foreign Currency Matters", the Company's balance sheet accounts are translated into U.S. dollars at the year-end or period end exchange rates and all revenue and expenses are translated into U.S. dollars at the average exchange rates prevailing during the periods in which these items arise. Translation gains and losses are deferred and accumulated as a component of other comprehensive income in stockholders' equity. Transaction gains and losses that arise from exchange rate fluctuations from transactions denominated in a currency other than the functional currency are included in the consolidated statement of income and comprehensive income as incurred.

The PRC government imposes significant exchange restrictions on fund transfers out of the PRC that are not related to business operations. These restrictions have not had a material impact on the Company because it has not engaged in any significant transactions that are subject to the restrictions.

Segment Reporting

The Company has only one business segment. All customers are located in the PRC. The majority of assets are located in the PRC. No segment reporting disclosure has been made.

Profit Appropriation

In accordance with PRC regulations, the PRC subsidiaries are required to make appropriations to the statutory surplus reserve fund, based on after-tax net income determined in accordance with PRC GAAP. Appropriation to the statutory surplus reserve fund should be at least 10% of the after-tax net income determined in accordance with PRC GAAP until the reserve is equal to 50% of the entity's registered capital. Statutory surplus reserve fund is non-distributable other than in liquidation.

Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standard Update No. 2010-06 ("ASU 2010-06"), "Improving Disclosures about Fair Value Measurements", which amends ASC 820 to add new requirements for disclosures related to amounts transferred into and out of Level 1 and 2 fair value measurements as well as separate disclosures of purchases, sales, issuances, and settlements related to amounts reported as Level 3 fair value measurements. ASU 2010-06 also clarifies existing fair value disclosure requirements related to the level of disaggregation and the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This guidance has been effective since the quarter ended March 31, 2010, except for the separate disclosures of purchases, sales, issuances, and settlements related to amounts reported as Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010.

The adoption of this guidance did not have a material impact on its results of operations or cash flows.



CHINA XD PLASTICS COMPANY LIMITED  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 3. ACCOUNTS RECEIVABLE

Accounts receivable consists of trade receivables resulting from sales of products during the normal course of business. Accounts receivable as of September 30, 2010 and December 31 2009 amounted to \$15,631,195 and \$8,558,172, respectively.

The Company collaborates directly with its end users on new product development, product certifications and post-sales support. Sales contracts are usually signed directly between the Company and its end users. Due to the nature of this industry, the Company also regularly uses distributors to sell its products to various end users. This arrangement can greatly assist to ensure timely collections of its accounts receivable and reduce its selling and administrative costs. The Company believes that all of the accounts receivable outstanding from these distributors are collectible (See Note 14).

The changes in allowance for doubtful receivables are summarized as follows:

|                   | September 30,<br>2010<br>US\$ | As of<br>December 31,<br>2009<br>US\$ |
|-------------------|-------------------------------|---------------------------------------|
| Beginning balance | 166,095                       | 99,669                                |
| Additions         | 28,836                        | 66,426                                |
| Ending balance    | 194,931                       | 166,095                               |

The allowance for doubtful receivables was recorded in general and administrative expenses.

Note 4. INVENTORIES

Inventories consist of the following:

|                  | September 30,<br>2010<br>US\$ | As of<br>December 31,<br>2009<br>US\$ |
|------------------|-------------------------------|---------------------------------------|
| Raw materials    | 13,848,723                    | 5,760,957                             |
| Work-in-progress | 659,841                       | 12,030,860                            |
| Finished goods   | 13,150,544                    | 570,701                               |
| Packing supplies | 6,627                         | 8,967                                 |
| Total            | 27,665,735                    | 18,371,485                            |

No allowance for inventories was made for the nine months ended September 30, 2010 and 2009.



CHINA XD PLASTICS COMPANY LIMITED  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 5. ADVANCES TO EMPLOYEES

Advances to employees represent cash advances to employees to purchase raw materials or equipment and other supplies for normal business purposes. The balance also included the proceeds receivable from employees in regard to Company automobiles sold to them in 2009. Advances to employees as of September 30, 2010 and December 31, 2009 amounted to \$223,255 and \$512,745, respectively.

Note 6. PROPERTY, PLANT AND EQUIPMENT, NET

The details of property, plant and equipment are as follows:

|                                | As of<br>September 30,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|--------------------------------|--|------------------------------|
| Machinery and equipment        | 31,394,450                             | 30,455,968                   |
| Automobiles                    | 133,191                                | 402,690                      |
| Plant and buildings            | 3,971,728                              | 3,863,746                    |
| Sub-total                      | 35,499,369                             | 34,722,404                   |
| Less: accumulated depreciation | (6,211,061 )                           | (3,667,959 )                 |
| Construction in progress       | 6,014,172                              | 28,944                       |
| Total                          | 35,302,480                             | 31,083,389                   |

Depreciation expense for the nine months ended September 30, 2010 and 2009 was \$2,477,951 and \$1,453,807, respectively. Certain property, plant and equipment have been pledged for short term loans (See Note 9).

Note 7. INTANGIBLE ASSET

Intangible asset consists of land use right only. All land in the PRC is government owned and cannot be sold to any individual or company. Instead, the government grants the user a land use right (“the Right”) to use the land.

The Company has the right to use the land for 50 years and amortizes the Right on a straight-line basis over the remaining useful life of 48 years from 2007 to 2055. The land use right was originally acquired in May 2005 for the amount of \$226,281.

Net intangible asset as of September 30, 2010 and December 31, 2009 was as follows:

|                | As of<br>September 30,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|----------------|--|------------------------------|
| Land use right | 272,917                                | 267,486                      |

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|                                |                |                |
|--------------------------------|----------------|----------------|
| Less: accumulated amortization | (30,324 )      | (25,541 )      |
| <b>Total</b>                   | <b>242,593</b> | <b>241,945</b> |

Amortization expense for the nine months ended September 30, 2010 and 2009 amounted to \$4,193 and \$4,176, respectively. Amortization expenses for the next five years amount to approximately \$5,500 each year. The land use right has been pledged for short term loans (See Note 9).

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Note 8. RELATED PARTY TRANSACTIONS

Amounts due to (+) and due from (-) affiliates are as follows:

|  | As of<br>September 30,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|--|--|------------------------------|
| XD Engineering   | (2,705 )                               | -                            |
| Harbin Xinda High-Tech Co., Ltd.<br>("Xinda High-tech) | 261,525                                | 148,397                      |
| Ms. Piao   | 1,769,147                              | -                            |
| Total  | 2,027,967                              | 148,397                      |

Prior to the reverse merger, Ms. Piao owned 100% of Favor Sea (BVI) indirectly via XD Engineering, the former sole shareholder of Favor Sea (BVI). Xinda Hi-Tech is an affiliated company owned by the spouse of Mr. Han, who was the major shareholder of Harbin Xinda before the ownership was transferred to HK Engineering Plastics.

On September 20, 2008, Harbin Xinda ("Buyer") signed an agreement ("Agreement") with Xinda High-Tech ("Seller") to acquire all of the assets of Xinda High-Tech, including plant and buildings, land use rights, machinery and equipment for a total amount of RMB240,000,000 (approximately \$35,136,006 at date of signing). Harbin Xinda was required to make two installment payments of the full purchase price of RMB50,000,000 by the end of December 31, 2008 and the remaining balance of RMB190,000,000 by the end of September 30, 2009 if all assets purchased are transferred to the Company. On May 1, 2009, Harbin Xinda and Xinda High-Tech agreed to rescind the Agreement.

Prior to signing of the above-mentioned Agreement, the Company rented the buildings and equipment of Xinda High-Tech for the purpose of its production expansion. The lease term was from May 1, 2008 to April 30, 2011. The lease payment was for a total of RMB2,000,000 per year. The lease contract was cancelled when Harbin Xinda and Xinda High-Tech rescinded the Agreement on May 1, 2009 and at the same time, Harbin Xinda and Xinda High-Tech re-signed a new lease agreement for the office and factory space at No. 9 Dalian North Road, Haping Road Centralized District, Harbin Development Zone, Harbin, Heilongjiang, China. The leased space is 23,893.53 square meters and the term of the lease is from May 1, 2009 to April 30, 2012. The lease payment remains at RMB2,000,000 per year. In the nine months ended September 30, 2010 and 2009, the Company recorded \$220,374 and \$219,542, respectively, for the rent expenses.

On May 18, 2010, New Research Center signed an agreement ("Agreement") with Xinda High-Tech to rent the office buildings of Xinda High-Tech located at No. 9 Dalian North Road, Haping Road Centralized District, Harbin Development Zone, Harbin, Heilongjiang, China. The lease term is from June 1, 2010 to May 31, 2013, with lease space of 2,801.19 square meters. The lease payment is RMB200,000 per year. In the nine months ended September 30, 2010, the Company recorded \$9,794 for the rent expenses.





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## Note 9. SHORT TERM LOANS

The short-term loans include the following:

|   | As of<br>September 30,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|---|--|------------------------------|
| a) Loan payable to Bank of Communications<br>one year term from December 8, 2009 to December 8, 2010 bears<br>interest of 10% above the prime rate* set by Central Bank of<br>China   | -                                      | 4,394,304                    |
| b) Loan payable to Bank of Communications<br>one year term from December 15, 2009 to December 13, 2010<br>bears interest of 10% above the prime rate* set by Central Bank<br>of China | 1,494,508                              | 1,464,768                    |
| c) Loan payable to Harbin Bank<br>one year term from February 24, 2009 to February 23, 2010 bears<br>a fixed interest rate of 7.124% per year   | -                                      | 4,394,304                    |
| d) Loan payable to Harbin Bank<br>one year term from April 3, 2009 to April 2, 2010 bears a fixed<br>interest rate of 7.124% per year   | -                                      | 10,692,805                   |
| e) Loan payable to Harbin Bank<br>three months term from December 25, 2009 to March 24, 2010<br>bears a fixed interest rate of 6.504% per year  | -                                      | 732,384                      |
| f) Loan payable to Bank of Communications<br>one year term from April 28, 2010 to April 27, 2011<br>bears interest rate of 5% above the prime rate* set by Central<br>Bank of China   | 4,483,528                              | -                            |
| g) Loan payable to Longjiang Bank<br>one year term from February 22, 2010 to February 21, 2011 bears<br>a fixed interest rate of 5.441% per year                                      | 4,483,528                              | -                            |
| h) Loan payable to Longjiang Bank<br>one year term from February 22, 2010 to February 21, 2011 bears<br>a fixed interest rate of 5.441% per year                                      | 4,483,528                              | -                            |
| i) Loan payable to Longjiang Bank<br>one year term from May 25, 2010 to February 21, 2011 bears a<br>fixed interest rate of 5.441% per year   | 2,989,018                              | -                            |
| j) Loan payable to Longjiang Bank<br>one year term from April 29, 2010 to February 21, 2011 bears a<br>fixed interest rate of 5.441% per year   | 2,989,018                              | --                           |
| <b>Total</b>  | <b>20,923,128</b>                      | <b>21,678,565</b>            |

\* The prime rate set by Central Bank of China as of September 30, 2010 was 5.31%.

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CHINA XD PLASTICS COMPANY LIMITED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 9. SHORT TERM LOANS (Continued)

The one-year short term loan of \$1,494,508 between Harbin Xinda and Bank of Communications for the period from December 15, 2009 to December 13, 2010 is secured by Harbin Xinda's pledge of certain of its machineries, and is guaranteed by Mr. Han and his wife.

The one-year short term loan of \$4,483,528 between Harbin Xinda and Bank of Communications for the period from April 28, 2010 to April 27, 2011 is secured by Xinda High-Tech's pledge of certain of its machineries.

The two one-year short term loans of \$4,483,528 each between Harbin Xinda and Longjiang Bank for the period from February 22, 2010 to February 21, 2011 are secured by Harbin Xinda's pledge of certain of its machinery.

The short term loan of \$2,989,018 each between Harbin Xinda and Longjiang Bank for the period from May 25, 2010 to February 21, 2011 is secured by Harbin Xinda's pledge of its land use right and buildings.

The other short term loan of \$2,989,018 between Harbin Xinda and Longjiang Bank for the period from April 29, 2010 to February 21, 2011 is secured by Xinda High-Tech's pledge of certain of its machineries.

Interest expense for the Company's short term loans totaled \$950,483 and \$1,033,183 for the nine months ended September 30, 2010 and 2009, respectively.

Note 10. INCOME TAXES

(a) Corporation Income Tax ("CIT")

No provision for income tax for China XD Plastics and Favor Sea (US) has been made as they incurred losses for the nine months ended September 30, 2010 and 2009.

HK Engineering Plastics' income is subject to taxation in Hong Kong at 16.5%. No provision for Hong Kong income tax has been made as HK Engineering Plastics has had no assessable profit since its incorporation.

Favor Sea (BVI) is not subject to income tax in any tax jurisdiction.

The subsidiaries operating in the PRC are subject to income taxes as described below:

Prior to January 1, 2008, Foreign Investment Enterprises were subject to the Foreign Enterprise Investment Income Tax ("FEIT"). Under that law, Foreign Investment Enterprises were generally subject to an income tax rate of 33% on all income, including foreign income. Qualified Foreign Investment Enterprises would receive a reduced national tax rate of 24% or 15%. Qualifying Foreign Investment Enterprises in the manufacturing sector were exempted from the FEIT for two years starting in the first year they became profitable, and received a 50% reduction in the FEIT or the subsequent three years, or a "two plus three" tax holiday. As such Harbin Xinda was exempt from paying the FEIT for 2007 and 2006.



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Note 10. INCOME TAXES (Continued)

Under the Enterprise Income Tax (“EIT,”) a uniform tax rate of 25% is applicable to both domestic and Foreign Investment Enterprises starting from January 1, 2008. For existing Foreign Investment Enterprises, the increased tax rate will be phased in. In addition to the rate increase, a majority of the favorable tax treatments currently enjoyed by Foreign Investment Entities are abolished, including the two plus three tax holiday, tax rate reductions relating to businesses located in specified regions of the country and income tax refunds for re-investments in China. Under the new law, Harbin Xinda is subject to the new tax rates and will lose the “two plus three” tax holiday that Harbin Xinda would have been entitled to under the old law. However, as a recipient of the High-Technology Enterprise Certificate from the Chinese government, Harbin Xinda is entitled to a rebate of a portion of the EIT. This rebate will reduce Harbin Xinda’s effective EIT tax rate to 15% from January 1, 2008 to December 31, 2010.

Income for the Research Institute is exempt from income tax under the current tax laws in the PRC.

Income for the New Research Center is subject to 25% statutory tax rate under the current tax laws in the PRC. However, New Research Center enjoys tax benefits per tax regulations on technology transfer in line with Implementation Regulations on Enterprise Income Tax of People’s Republic of China. Income over RMB5 Million is subject to 12.5% tax rate, income below RMB5 Million is fully exempt.

The following table reconciles the statutory rates to the Company’s effective tax rate for the nine months ended September 30, 2010 and 2009:

|   | 2010   |    | 2009<br>(Restated-Note 18) |    |
|---|--------|----|----------------------------|----|
| PRC statutory rate                            | 25.00  | %  | 25.00                      | %  |
| Effect of tax rates in different jurisdiction | 15.57  | %  | 4.68                       | %  |
| Effect of non-deductible expenses             | 1.68   | %  | 0.28                       | %  |
| Effect of non-taxable income                  | (6.77  | %) | -                          |    |
| Changes in valuation allowance                | 2.19   | %  | 12.18                      | %  |
| Effect of tax exemption of PRC subsidiaries   | (36.85 | %) | (41.83                     | %) |
| Effective income tax rate                     | 0.82   | %  | 0.31                       | %  |

As of September 30, 2010, China XD Plastics and Favor Sea (US) had accumulated net operating loss carryforwards for United States federal tax purposes of approximately \$4,717,140, that are available to offset future taxable income. Realization of the net operating loss carryforwards is dependent upon future profitable operations. In addition, the carryforwards may be limited upon a change of control in accordance with Internal Revenue Code Section 382, as amended. Accordingly, management has recorded a valuation allowance to reduce deferred tax assets associated with the net operating loss carryforwards to zero at September 30, 2010. The net operating loss carryforwards expire in years 2027 through 2030.



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## Note 10. INCOME TAXES (Continued)

As of September 30, 2010, deferred tax assets consist of:

|                                   | September 30,<br>2010<br>US\$ |
|-----------------------------------|-------------------------------|
| Net operating loss carry forwards | 1,603,828                     |
| Less: valuation allowance         | (1,603,828)                   |
| Net                               | -                             |

## (b) Value Added Tax (“VAT”)

Enterprises or individuals who sell commodities, engage in repairs and maintenance or import or export goods in the PRC are subject to a value added tax in accordance with the PRC laws. The value added tax standard rate is 17% of the gross sales price. A credit is available whereby VAT paid on the purchases of semi-finished products or raw materials used in the production of the Company’s finished products can be used to offset the VAT due on the sales of the finished products.

## Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK

On December 1, 2009 (the “Closing Date”), China XD Plastics entered into a securities purchase agreement (the “Purchase Agreement”), with several investors, including institutional, accredited and non-US persons and entities (the “Investors”), pursuant to which China XD Plastics sold units, comprised of 6% Series C convertible redeemable preferred stock, par value \$0.0001 per share (the “Series C preferred stock”), and two warrants, for a purchase price of \$4.60 per unit (the “December 2009 Financing”). The Company sold 15,188 units in the aggregate, which included (i) 15,188 shares of Series C preferred stock, (ii) Series A warrants to purchase 1,320,696 shares of common stock at an exercise price of \$5.50 per share with a five-year term, and (iii) Series B warrants to purchase 1,178,722 shares of common stock at an exercise price of \$0.0001 with a five-year term. Net proceeds were approximately \$13,891,477, net of issuance costs of approximately \$719,400 in cash and warrants to placement agent valued at \$577,123. Rodman Renshaw acted as placement agent and received (i) a placement fee in the amount equal to 5% of the gross proceeds and (ii) warrants to purchase up to 117,261 shares of common stock at an exercise price of \$5.50, with a five-year term (“Placement Agent Warrants” and together with the Series A warrants and Series B warrants, the “Warrants” or “Investor Warrants”).

Key terms of the Series C preferred stock sold by the Company in December 2009 financing are summarized as follows:

## Dividends

Dividends on the Series C preferred stock shall accrue and be cumulative from and after the issuance date. For each outstanding share of Series C preferred stock, dividends are payable at the per annum rate of 6% of the liquidation preference amount of the Series C preferred stock. Dividends are payable quarterly on the business day following the

last business day of each December, June, and September of each year (each, a “Dividend Payment Date”), and continuing until such stock is fully converted or redeemed. Preferred stock holders are entitled to convert any unpaid dividends per preferred stock then remaining, into fully paid and nonassessable shares of common stock at a mutually agreed conversion rate.



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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

Voting Rights

The Series C preferred stock holders are entitled to vote separately as a class on matters affecting the Series C preferred stock and with regard to certain corporate matters set forth in the Series C Certificate of Designation, so long as any shares of the Series C preferred stock remain outstanding. Holders of the Series C preferred stock are not, however, entitled to vote on general matters along with holders of common stock.

Liquidation Preference

In the event of a liquidation event, the holders of the Series C preferred stock then outstanding shall be entitled to receive in cash out of the assets of the Company available for distribution to its stockholders, an amount equal to \$1,000 per share of the Series C preferred stock, plus any accrued but unpaid dividends thereon, whether or not declared, together with any other dividends declared but unpaid thereon, as of the date of liquidation before any payment shall be made or any assets distributed to the holders of the common stock or any other junior stock. If upon the occurrence of liquidation, the assets thus distributed among the holders of the Series C preferred stock shall be insufficient to permit the payment to such holders of the full Series C preferred stock amount, then the entire assets of the Company legally available for distribution shall be distributed ratably among the holders of the Series C preferred stock.

Conversion Rights

i) Voluntary Conversion

At any time on or after the date of the initial issuance of the Series C preferred stock, the holder of any such shares of Series C preferred stock may, at such holder's option, convert any whole number of preferred shares, plus the amount of any accrued but unpaid dividends per preferred share then remaining, into fully paid and nonassessable shares of common stock at the initial conversion price of \$4.60 per share. The initial conversion price may be adjusted for stock splits and combinations, dividend and distributions, reclassification, exchange or substitution, reorganization, merger, consolidation or sales of assets as stimulated in the Certification of Designations.

ii) Mandatory Redemption

If any preferred shares remain outstanding on the maturity date of December 1, 2012, the Company shall redeem such preferred shares in cash in an amount equal to the outstanding conversion amount for each such preferred share (See "Accounting for the Series C Preferred Stock" below).

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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

Conversion Restriction

Holders of the Series C preferred stock may not convert the preferred stock to common stock if the conversion would result in the holder beneficially owning more than 4.99% of the Company's outstanding shares of common stock. That limitation may be waived by a holder of the Series C preferred stock and an increase or decrease in the maximum percentage to any other percentage not in excess of 9.99% may be specified in such notice by sending a written notice to the Company on not less than 61 days prior to the date that they would like to waive the limitation.

Registration Rights Agreement

In connection with the financing, the Company entered into a registration rights agreement (the "RRA") with the investors in which the Company agreed to file a registration statement (the "Registration Statement") with the SEC to register the shares of common stock underlying the Series C preferred stock and the Warrants, thirty (30) days after the closing of the financing. The Company has agreed to use its best efforts to have the Registration Statement declared effective within 60 calendar days after filing, or 180 calendar days after filing in the event Cutback Shares are required and the Additional Registration Statement is required to cover Additional Registrable Securities.

The Company is required to keep the Registration Statement continuously effective under the Securities Act until such date as is the earlier of the date when all of the securities covered by that Registration Statement have been sold or the date on which such securities may be sold without any restriction pursuant to Rule 144 (the "Financing Effectiveness Period"). The Company will pay liquidated damages of 2% of each holder's initial investment in the Units sold in the Financing, payable in cash, if the Registration Statement is not filed or declared effective within the foregoing time periods or ceases to be effective prior to the expiration of the Financing Effectiveness Period. In the event the Company fails to make Registration Delay Payments in a timely manner, such Registration Delay Payments shall bear interest at the rate of one and one-half percent (1.5%) per month (prorated for partial months) until paid in full. However, no liquidated damages shall be paid with respect to any securities being registered that the Company is not permitted to include in the Financing Registration Statement due to the SEC's application of Rule 415.

The Company evaluated the contingent obligation related to the RRA liquidated damages in accordance with FASB ASC 825-20, which requires the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, to be separately recognized and measured in accordance with FASB ASC 450. The Company concluded that such obligation was not probable to be incurred based on the best information and facts available as of December 31, 2009. Therefore, no contingent obligation related to the RRA liquidated damages was recognized as of December 31, 2009.

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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

The Company's registration statement filed with the SEC in connection with the issuance of Series C preferred stock was declared effective on February 19, 2010.

Accounting for the Series C preferred stock

The Series C preferred stock is mandatorily redeemable on December 1, 2012, at a conversion amount equal to the stated value plus the additional amount. The additional amount is a formula based on the 6% dividend rate and the time that the preferred stock is outstanding. The Company used the guidance of FASB ASC 480-10-S99, "Distinguishing Liabilities from Equity" which states that equity instruments with redemption features that are not solely within the control of the issuer to be classified temporary equity. The Company's Series C preferred stock is contingently redeemable as it is convertible until the end of the third anniversary.

Embedded Conversion Feature

FASB ASC 815 indicates that an embedded conversion features should be considered to be a derivative if the following criteria are met:

- i) The economic characteristics and risks differ between the host and embedded conversion feature. This condition, relative to our Series C preferred stock, is met because the preferred stock has a mandatory redemption feature at the discretion of the holders instead of the Company. Hence, the conversion feature is not clearly and closely related to the economic characteristics of the host contract. The embedded derivative (that is, the conversion option) must be separated from its host contract and accounted for as a derivative liability provided that the conversion option would, as a freestanding instrument, be a derivative instrument.
- ii) The contract that includes the host and the conversion feature is not re-measured at fair value. This condition is met because the contract (Series C preferred stock) is not to be re-measured at fair value.
- iii) A separate instrument with the same terms as the embedded conversion feature would be derivative as per paragraph 6 of FASB ASC 815. Our review of paragraph 6 revealed that the embedded conversion feature without a host would be considered a derivative because the embedded conversion feature (1) has underlying and notional amounts (2) requires no initial net investments and (3) permits net settlement.

Based on the above considerations, the embedded conversion features related to our Series C preferred stock is a derivative that must be bifurcated from the host instrument and accounted for at fair value with changes in fair value recorded in earnings.

During the nine months ended September 30, 2010, 15,186 out of total 15,188 shares of Series C preferred stock were converted into 3,301,300 shares of common stock. The conversion of Series C preferred stock resulted in a fair value gain of \$3,300,661 recorded in earnings and a credit of \$15,495,392 to additional paid-in capital during the nine months ended September 30, 2010.



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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

The Company calculated the fair value of the embedded conversion feature at September 30, 2010 to be \$2,006 using the Black-Scholes option pricing model using the following assumptions:

- risk free rate of return of 0.64%
  - volatility of 158.80%
  - dividend yield of 6.0%
- expected term of 2.17 years

The fair value gain of the embedded conversion feature of \$217,739 was recorded in earnings.

The movements of embedded conversion feature are summarized as follows:

|   | US\$         |
|---|--------------|
| Issuance of preferred stock on December 1, 2009     | 16,812,682   |
| Adjustment to fair value change                     | 1,985,377    |
| Balance as of December 31, 2009 and January 1, 2010 | 18,798,059   |
| Conversion of preferred stock to common shares      | (15,495,392) |
| Adjustment to fair value change upon conversion     | (3,082,922)  |
| Adjustment to fair value change                     | (217,739)    |
| Balance as of September 30, 2010                    | 2,006        |

Cash Dividend to Holders of Series C Preferred Stock

As of September 30, 2010, 15,186 out of total issued and outstanding 15,188 shares of Series C preferred stock have been converted into 3,301,300 common shares and the Company has made cash dividend payments of \$1,796,337 to the holders who converted their preferred shares.

Stock Dividend to Holders of Series C Preferred Stock

On April 27, 2010, three holders of Series C preferred stock elected to receive their dividend payments in the form of restricted common stock aggregated to 24,545 shares, in connection with their conversion of all their series C preferred shares pursuant to the provisions in the Certification of Designation of Series C Preferred Stock.

Accounting for Warrants

The Warrants have an initial exercise price which is subject to adjustments in certain circumstances for stock splits, combinations, dividends and distributions, reclassification, exchange or substitution, reorganization, merger, consolidation or sales of assets, issuance of additional shares of common stock or equivalents. The Warrants may not be exercised if it would result in the holder beneficially owning more than 4.99% of the Company's outstanding common shares.

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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

The Company analyzed the Warrants in accordance with FASB ASC 815, to determine whether the Warrants meet the definition of a derivative and, if so, whether the Warrants meet the scope exception of FASB ASC 815, which is that contracts issued or held by the reporting entity that are both (1) indexed to its own stock and (2) classified in stockholders' equity shall not be considered to be derivative instruments for purposes of FASB ASC 815.

The Company also considered the provisions of FASB ASC 815-40, which applies to any freestanding financial instruments or embedded features that have the characteristics of a derivative as defined by FASB ASC 815, and to any freestanding financial instruments that are potentially settled in an entity's own common stock.

As a result of its interpretation of FASB ASC 815-40, the Company concluded that the Warrants issued in the December 2009 financing should be treated as a derivative liability because the Warrants are entitled to a price adjustment provision to allow the exercise price to be reduced in the event the Company issues or sells any additional shares of common stock at a price per share less than the then-applicable exercise price or without consideration, which is typically referred to as a "Down-round protection" or "anti-dilution" provision. According to FASB ASC 815-40, the "Down-round protection" provision is not considered to be an input to the fair value of a fixed-for-fixed option on equity shares which leads the Warrants to fail to be qualified as indexed to the Company's own stock and then to fail to meet the scope exceptions of FASB ASC 815. Therefore, the Company accounted for the Warrants as derivative liabilities under FASB ASC 815. Pursuant to FASB ASC 815, derivatives are measured at fair value and re-measured at fair value with changes in fair value recorded in earnings at each reporting period.

Series A warrants

The Company estimated the fair value of the Series A warrants using the Black Scholes option-pricing model and available information that management deems most relevant.

The Company calculated the fair value of the Series A warrants at September 30, 2010 to be \$6,150,167 compared to the fair value of \$7,248,903 as of December 31, 2009, using the Black-Scholes option-pricing model using the following assumptions:

- risk free rate of return of 1.27%
- volatility of 158.80%
- dividend yield of 6.0%
- expected term of 4.17 years

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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

The volatility of 158.80% was determined by taking the Company's stock price from February 13, 2009 through November 13, 2009 and December 2, 2009 through September 30, 2010. The Company believes that the stock price immediately after the reverse merger to February 12, 2009 remained constant. Moreover, the stock price was extremely volatile from November 14, 2009 to December 1, 2009, when it began trading on NASDAQ.

The change in fair value of the Warrants of \$1,098,736 was recorded in earnings for the nine months ended September 30, 2010.

Series B warrants

The Series B warrants were not valued at the date of the agreement because the price will not be known until the Price Reset Date.

Placement Agent Warrants

In accordance with Staff Accounting Bulletin Topic 5.A: "Miscellaneous Accounting-Expenses of Offering" which is now codified as FASB ASC 340-10-S99-1", "specific incremental costs directly attributable to a proposed or actual offering of securities may properly be deferred and charged against the gross proceeds of the offering." In accordance with the SEC Accounting and Reporting Manual, "costs of issuing equity securities are charged directly to equity as deduction of the fair value assigned to shares issued." Accordingly, the Company concluded that the Placement Agent Warrants are directly attributable to the December 2009 financing. If the Company had not issued the Placement Agent Warrants, the Company would have had to pay the same amount of cash as the fair value. Therefore, the Company deducted the total fair value of the Placement Agent Warrants as of the commitment date, which was approximately \$577,123, against the gross proceeds.

Since the Placement Agent Warrants contain the same terms as the Investor Warrants, the Placement Agent Warrants are also entitled to the benefits of the "down-round protection" provisions, which means that the Placement Agent Warrants will also need to be accounted for as a derivative under FASB ASC 815 with changes in fair value recorded in earnings at each reporting period. As of September 30, 2010, the total fair value of the Placement Agent Warrants was \$546,057, compared to the fair value of \$643,610 as of December 31, 2009; therefore, the change of the total fair value of the Placement Agent Warrants of \$97,553 was recorded in earnings for the nine months ended September 30, 2010.

The registered holders of the Investor and Placement Agent Warrants are entitled to purchase common shares from the Company at any time or times on or after the date immediately after the six month anniversary until the sixty month anniversary after the issuance date.



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Note 11. SERIES C CONVERTIBLE REDEEMABLE PREFERRED STOCK (Continued)

The movement of common stock warrant purchase liabilities is summarized as follows:

|  | Series A<br>warrants<br>US\$ | Placement<br>Agent<br>warrants<br>US\$ | Total<br>US\$ |
|--|------------------------------|--|---------------|
| Issuance of common stock warrants on<br>December 1, 2009 | 6,500,059                    | 577,123                                | 7,077,182     |
| Adjustment to fair value change                          | 748,844                      | 66,487                                 | 815,331       |
| Balance as of December 31, 2009 and<br>January 1, 2010   | 7,248,903                    | 643,610                                | 7,892,513     |
| Adjustment to fair value change                          | (1,098,736)                  | (97,553)                               | (1,196,289)   |
| Balance as of September 30, 2010                         | 6,150,167                    | 546,057                                | 6,696,224     |

Allocation of proceeds on December 31, 2009

The fair value of the embedded conversion feature and warrants of \$23,312,741 was recorded as follows:

- i) the Company recorded a deemed preferred stock dividend of \$13,891,477; and
- ii) the excess of the fair values of the embedded conversion feature and warrants over the net proceeds received of \$9,421,264 was charged to changes in fair value of warrants and embedded derivatives in the statement of income and comprehensive income.

Note 12. STOCK-BASED COMPENSATION

The Company adopted the 2009 Stock Incentive Plan (the "2009 Plan") on May 26, 2009, which reserved 7,800,000 shares of common stock for issuance. The 2009 Plan allows the Company to issue awards of incentive non-qualified stock options and stock bonuses to directors, officers, employees and consultants of the Company, which may be subject to restrictions. The Company applied FASB ASC 718 and related interpretations in accounting for the 2009 Plan. Compensation for services that a corporation receives under FASB ASC 718 through share-based compensation plans should be measured by the quoted market price of the stock at the grant date less the amount, if any, that the individual is required to pay.

Stock compensation expense recognized is based on awards expected to vest. The fair value of the stock compensation is amortized over the respective vesting period based on the terms of the employment or service agreements under which the stock was awarded.



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Note 12. STOCK-BASED COMPENSATION (Continued)

The fair value of the stock-based compensation expense amortized for the nine months ended September 30, 2010 and 2009 was \$1,374,381 and \$3,191,430, respectively.

Stock Options Issued to Employees and Directors

On August 7, 2010, the Company's compensation committee approved the issuance of 445,500 options to purchase shares of the Company's common stock to certain executive officers and employees. One-third (1/3) of the options will vest yearly on a calendar basis over a three-year period commencing on the date of grant. The exercise price shall be the greater of (i) \$8.01 or (ii) 85% of the fair market value as determined under the Company's stock option plan on the date of the grant.

The fair value of stock options granted was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions: expected life 2 years, expected volatility 158.8%, dividend yield 0.00%, risk free interest rate 0.42% and exercise price of \$8.01.

Following is a summary of the stock option activity:

|                                      | Number of<br>Options<br>Outstanding | Weighted<br>Average<br>Exercise Price<br>US\$ | Aggregate<br>Intrinsic<br>Value<br>US\$ |
|--------------------------------------|-------------------------------------|---|---|
| Balance as of December 31, 2009      | -0-                                 | -0-   | -0-                                     |
| Granted                              | 445,500                             | 8.01  | 596,970                                 |
| Outstanding as of September 30, 2010 | 445,500                             | 8.01  | 596,970                                 |
| Exercisable as of September 30, 2010 | -                                   | -   | -                                       |
| Unvested as of September 30, 2010    | 445,500                             | 8.01  | 596,970                                 |

The aggregate intrinsic value in the table above represents the total intrinsic value (i.e., the difference between the Company's closing stock price of US\$6.67 on September 30, 2010 and the exercise price, times the number of options) that would have been received by the option holders had all option holders exercised their options on September 30, 2010. The total intrinsic value of options exercised during the period ended September 30, 2010 was nil. The number of options vested during the period ended September 30, 2010 was nil. The weighted average remaining contractual term of the outstanding options at September 30, 2010 was 2.

As of September 30, \$2,007,090 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted average period of 2.85 years.

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Note 12. STOCK-BASED COMPENSATION (Continued)

A summary of the restricted stock unit activity is as follows:

|   | Restricted<br>Stock Units | Weighted-<br>Average Grant<br>Date Price per<br>Share<br>\$ | Aggregated<br>Fair Market<br>Value<br>\$ |
|---|---------------------------|---|--|
| Balance at January 1, 2010                                    | 942,024                   | 3.06  | 2,883,541                                |
| Granted   | 99,856                    | 6.57  | 656,054                                  |
| Vested  | (942,024)                 | 3.06  | 2,883,541                                |
| Balance at September 30, 2010 (granted<br>but not yet vested) | 99,856                    | 6.57  | 656,054                                  |

As of September 30, 2010, 5,890,120 (December 31, 2009: 5,989,976) share-based awards were available for grant.

Note 13. STOCKHOLDERS' EQUITY

(a) Common Stock

Issuance of Common Stock

Prior to the reverse merger, China XD Plastics had 49,632,222 shares of common stock issued and outstanding at \$.0001 per share. In connection with the reverse merger consummated on December 24, 2008, all of these outstanding shares were subject to a 124.1 for 1 reverse split for all record holders of China XD Plastics' common stock on the date of December 31, 2008. The number of the post reverse-split of the original common stock outstanding was rounded up to 400,000 shares.

In consideration for the Merger, China XD Plastics issued 10 shares of the common stock and 1,000,000 shares of convertible Series A preferred stock to the shareholders of Favor Sea (BVI), and also 1,000,000 shares of Series B preferred stock to XD Engineering, the principal shareholder of Favor Sea (BVI). The 10 shares of the common stock issued to shareholders of Favor Sea BVI were converted into approximately 50,367,778 shares of the common stock of China XD Plastics prior to and approximately 405,802 post a reverse stock split of 124.1 for 1. The equity account of Favor Sea (BVI), prior to the merger date, has been retroactively restated so that the ending outstanding share balance as of the merger date is equal to the number of post reverse-split shares received in the merger.

As a part of the Merger Agreement effected on December 24, 2008, 1,000,000 shares of Series A preferred stock were automatically converted into 38,194,072 shares of common stock on April 20, 2009 after China XD Plastics' effective filing to increase its authorized shares.



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Note 13. STOCKHOLDERS' EQUITY (Continued)

On June 5, 2009, China XD Plastics issued 1,790,000 common shares to some employees and consultants as stock compensation in connection with the services rendered or to be rendered in 2009. Among these shares, 868,000 vested in 2009 and 922,000 vested during the nine months ended September 30, 2010.

On September 2, 2009, the Company issued 20,024 common shares to four independent directors in connection with the service agreements between China XD Plastics and the directors. These shares vested during the six months ended June 30, 2010.

On November 16, 2009, a consultant exercised its warrants and received 57,152 shares of common stock.

During the nine months ended September 30, 2010, 15,186 shares series C preferred stock were converted into 3,301,300 shares of common stock.

On August 7, 2010, the Company's compensation committee approved the issuance of 99,856 shares of restricted stock to its four (4) independent directors and certain executive officers and employees. The restricted shares issued to independent directors and employees were granted for their services rendered to the Company. The shares issued to independent directors vest six (6) months after the issuance date and three (3) years for the employees.

As of September 30, 2010, there are 44,295,033 shares of common stock issued and outstanding. There are also 1,000,000 shares of Series B Preferred Stock issued and outstanding, and all of the issued and outstanding shares of Series B Preferred Stock have voting power equal to 40% of the total voting power of all of the issued and outstanding shares of the common stock.

Note 14. SIGNIFICANT CONCENTRATION

Two (2) major vendors provided approximately 99% of the Company's purchases of raw materials for the nine months ended September 30, 2010, with each vendor individually accounting for approximately 50% and 49%, respectively. The advance to one of the vendors was \$21,601,278 and \$19,629,245 as of September 30, 2010 and December 31, 2009, respectively.

Two (2) major vendors provided approximately 98% of the Company's purchases of raw materials for the nine months ended September 30, 2009, with each vendor individually accounting for 50% and 48%, respectively.

Two (2) major vendors provided approximately 97% of the Company's purchases of raw materials for the three months ended September 30, 2010, with each vendor individually accounting for 50% and 47%, respectively. Two (2) major vendors provided approximately 93% of the Company's purchases of raw materials for the three months ended September 30, 2009, with each vendor individually accounting for 52% and 41%, respectively.

Sales to three major distributors accounted for approximately 78% of the Company's sales for the nine months ended September 30, 2010, with each distributor individually accounting for 55%, 12% and 11%, respectively.



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Sales to four major distributors accounted for approximately 85% of the Company's sales for the three months ended September 30, 2010, with each distributor individually accounting for 49%, 13%, 12% and 11%, respectively.

Sales to one major distributor accounted for approximately 86% and 76%, respectively, of the Company's sales for the nine and three months ended September 30, 2009.

Note 15. EARNINGS PER SHARE

EPS information is determined using the two-class method, which includes the weighted-average number of common shares outstanding during the period and other securities that participate in dividends ("participating securities"). Our unvested shares and Series C preferred stock are considered "participating securities" because they include non-forfeitable rights to dividends. In applying the two-class method, earnings are allocated to both common stock and participating securities based on their respective weighted-average shares outstanding for the period. Diluted EPS information may include the additional effect of other securities, if dilutive, in which case the dilutive effect of such securities is also calculated using the two-class method. In applying the two-class method, the basic and diluted EPS were reduced by \$0.02, for the nine months ended September 30, 2010. The basic EPS was reduced by \$0.02 for the nine months ended September 30, 2009.

The following table sets forth the computation of basic EPS for the periods indicated:

|   | Nine Months Ended |              | Three Months Ended |              |
|---|-------------------|--------------|--------------------|--------------|
|   | September 30,     |              | September 30,      |              |
|   | 2010              | 2009         | 2010               | 2009         |
|   | (Restated)        | (Restated)   | (Restated)         | (Restated)   |
| <b>Numerator</b>  |                   |              |                    |              |
| Net income attributable to China XD                           | \$ 22,389,061     | \$ 9,904,284 | \$ 12,263,077      | \$ 3,956,640 |
| Less: Dividend paid   |                   |              |                    |              |
| -Series C preferred shares                                    | (2,723,397 )      | -            | (60 )              | -            |
| Undistributed earnings  | 19,665,664        | 9,904,284    | 12,263,017         | 3,956,640    |
| <b>Less:</b>  |                   |              |                    |              |
| Earnings allocated to participating Series C preferred shares | (446,433 )        | -            | (120 )             | -            |
| Earnings allocated to participating unvested shares           | (240,593 )        | (294,224 )   | (16,241 )          | (160,621 )   |
| Net income allocated to common stockholders                   | \$ 18,978,638     | \$ 9,610,060 | \$ 12,246,656      | \$ 3,796,019 |
| <b>Denominator:</b>   |                   |              |                    |              |
| Weighted average shares of common stock                       | 42,659,612        | 23,797,464   | 44,195,177         | 39,140,048   |
| Basic earnings per common stock                               | \$ 0.44           | \$ 0.40      | \$ 0.28            | \$ 0.10      |



The following table sets forth the computation of dilutive earnings per share for the periods indicated:

|  | Nine Months Ended                   |                    | Three Months Ended                  |                    |
|--|-------------------------------------|--------------------|-------------------------------------|--------------------|
|  | September 30,<br>2010<br>(Restated) | 2009<br>(Restated) | September 30,<br>2010<br>(Restated) | 2009<br>(Restated) |
| Numerator  |                                     |                    |                                     |                    |
| Net income allocated to common stockholders as reported in Basic EPS             | \$ 18,978,638                       | \$ 9,610,060       | \$ 12,246,656                       | \$ 3,796,019       |
| Change in fair value of derivative liabilities-Series A investor warrants        | (1,098,736 )                        | -                  | (80,828 )                           | -                  |
| Change in fair value of derivative liabilities-Series A placement agent warrants | (97,553 )                           | -                  | (7,177 )                            | -                  |
| Net income allocated to common stockholders                                      | \$ 17,782,349                       | \$ 9,610,060       | \$ 12,158,651                       | \$ 3,796,019       |
| Denominator:   |                                     |                    |                                     |                    |
| Weighted average shares of common stock as reported in Basic EPS                 | 42,659,612                          | 23,797,464         | 44,195,177                          | 39,140,048         |
| Convertible Series A preferred stock   | -                                   | 15,249,648         | -                                   | -                  |
| Warrants issued to CCG   | -                                   | -                  | -                                   | 48,073             |
| Dividend payable   | 144,022                             | -                  | 144,022                             | -                  |
| Dilutive effect of Series A investor warrants                                    | 253,646                             | -                  | 176,505                             | -                  |
| Dilutive effect of Series A placement agent warrants                             | 22,521                              | -                  | 15,671                              | -                  |
| Weighted average shares of common stock  | 43,079,801                          | 39,047,112         | 44,531,375                          | 39,188,121         |
| Dilutive earnings per common stock   | \$ 0.41                             | \$ 0.25            | \$ 0.27                             | \$ 0.10            |

The Company identified a mathematical error in the computation of dilutive EPS in prior periods' financial statements, in which the Company did not deduct the changes in fair values of warrants from net income attributable to common stockholders for the purpose of calculation of dilutive EPS. As a result, dilutive EPS for the nine months ended September 30, 2010 was reduced by \$0.02 per share and the dilutive EPS for the three months ended September 30, 2010 was reduced by \$0.01 per share. This adjustment only impacted the condensed consolidated statements of income and other comprehensive income below the operating line and is non-cash in nature. It had no effect on total assets, total liabilities, net income or cash flows as previously reported.

The Company had outstanding common stock purchase warrants of 1,437,957 and nil, respectively, on September 30, 2010 and 2009. As of September 30, 2010 and 2009, because the market price was higher than the exercise price, the

warrants were dilutive and included in diluted weighted average share calculation.

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The Company had stock options of 445,500 valued at \$117,938 as of September 30, 2010. Because the exercise price was higher than the market price, these options were anti-dilutive and not included in diluted weighted shares calculation.

Note 16. COMMITMENTS AND CONTINGENCIES

As of September 30, 2010, the Company leased buildings and facilities in Harbin and the leases will expire on April 30, 2012 and May 30, 2013. Rental expenses for the nine months ended September 30, 2010 and 2009 amounted to \$230,168 and \$219,542, respectively. The rental expenses are included in general and administrative expenses.

As of September 30, 2010, the Company rented an office in the U.S. and the lease will expire on November 30, 2010. Rental expenses for the nine months ended September 30, 2010 and 2009 amounted to \$68,760 and \$97,967, respectively.

The future minimum lease payments under the above mentioned leases as of September 30, 2010 are as follows:

| Year ending December 31, | US\$    |
|--------------------------|---------|
| 2010                     | 93,987  |
| 2011                     | 328,792 |
| 2012                     | 129,524 |
| 2013                     | 12,454  |
| Total                    | 564,757 |

As of September 30, 2010, HK Engineering Plastics had a commitment in respect of capital contribution to Harbin Xinda of approximately \$11,000,000 (RMB75,000,000), which has to be paid by December 3, 2011.

In September 2010, Research Institute entered into two equipment purchase contracts with Harbin Jiamu Import and Export Trading Co., Ltd. (“Seller”), pursuant to which, Research Center purchased various equipment valued at RMB41,000,000 (equivalent to approximately \$6,100,000). As of September 30, 2010, the Company paid RMB40,000,000 and the retention of RMB1,000,000 is expected to be paid within one year.

Note 17. DISTRICT ENTRY AGREEMENT

On April 14, 2010, China XD Plastics, through its subsidiary Harbin Xinda, entered into a District Entry Agreement (the “DE Agreement”) and a Memorandum (the “Memo”) with Harbin Economic and Technological Development Zone Administration (the “Administration”). Pursuant to the DE Agreement, Harbin Xinda agreed to relocate all its manufacturing facilities of the Qinling Road Factory and change its business address and tax registration to Ha Ping Road Centralized Industrial Park where Dalian Road Factory is located. Following the relocation of such manufacturing facilities, and upon the completion of the business address change and tax registration with the Development Zone of the new location, the Administration will pay a total of approximately \$3 million (RMB 20 million) to Harbin Xinda as business relocation subsidies. According to the payment terms of the DE Agreement, approximately \$1.5 million (RMB 10 million) will be paid within seven days of the completion of Harbin Xinda’s business address change and tax registration and the remaining approximately \$1.5 million (RMB 10 million) will be paid in the corresponding period the following month.



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During the nine months ended September 30, 2010, \$3 million (RMB 20 million) was received. However, Harbin Xinda has to return the relocation subsidy, plus interest, to the Administration if Harbin Xinda's revenue does not reach RMB 1.3 billion for the year ending December 31, 2010. The Company did not recognize the subsidy in other income as in accordance with FASB ASC 450-30-25, the gain is contingent upon the Company meeting the revenue target as stipulated in the DE Agreement and the Memo. Therefore, it was recorded in other payables.

During the nine months ended September 30, 2010, relocation expenses of \$172,950 was paid to the Administration in accordance with DE Agreement.

Note 18. RESTATEMENT TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009

The Company has restated the consolidated financial statements for the nine months ended September 30, 2009 as a result of a non-cash error regarding the accounting for stock options (the "Options") granted to a director, Mr. Jie Han ("Mr. Han"), pursuant to the requirements of ASC Topic 718.

Pursuant to an incentive option agreement dated May 16, 2008, Ms. Qiuyao Piao ("Ms. Piao") granted 40,000 Options to Mr. Han to purchase shares of XD Engineering Plastics Company Limited ("XD Engineering") at a nominal price if certain performance targets are met. Ms. Piao is the sole shareholder of XD Engineering, which is the Company's controlling shareholder. Mr. Han may purchase 25% of the total outstanding equity in XD Engineering if the Company's consolidated revenue during the first three quarters of 2008 exceeds \$40,000,000. He may purchase 14% of the total outstanding equity in XD Engineering if the Company's consolidated revenue during the first three quarters of 2009 exceeds \$70,000,000. Finally, he may purchase 61% of the total outstanding equity in XD Engineering if the Company's revenue during the first three quarters of 2010 exceeds \$110,000,000.

In accordance with ASC Topic 718, the Options should have been accounted for in the Company's consolidated financial statements as share-based payments awarded to an employee by a related party as compensation for services rendered.

The Company's restated its consolidated financial statements for the nine months ended September 30, 2009 to incorporate the additional stock-based compensation expense in respect of the options granted to Mr. Han of \$3,065,388.

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The following tables reconcile the previously filed quarterly results to the restated quarterly results for the nine months ended September 30, 2009.

|                                     | As previously<br>reported<br>US\$ | Adjustment<br>US\$ | As restated<br>US\$ |
|-------------------------------------|-----------------------------------|--------------------|---------------------|
| General and administrative expenses | 5,768,050                         | 3,065,388          | 8,833,438           |
| Total operating expenses            | 6,860,563                         | 3,065,388          | 9,925,951           |
| Operating income                    | 13,981,484                        | (3,065,388)        | 10,916,096          |
| Income before income taxes          | 13,000,313                        | (3,065,388)        | 9,934,925           |
| Net income                          | 12,969,672                        | (3,065,388)        | 9,904,284           |
| Comprehensive income                | 12,923,066                        | (3,065,388)        | 9,857,678           |
| Earnings per share-basic:           | 0.54                              | (0.12)             | 0.42                |
| Earnings per share-diluted:         | 0.33                              | (0.08)             | 0.25                |
| Weighted average number of shares:  |                                   |                    |                     |
| Basic:                              | 23,797,701                        | -                  | 23,797,701          |
| Diluted:                            | 39,206,884                        | -                  | 39,206,884          |
| Additional paid-in-capital          | 5,670,316                         | 8,539,295          | 14,209,611          |
| Retained earnings                   | 33,020,813                        | (8,539,295)        | 24,481,518          |

Note 19. SUBSEQUENT EVENTS

1) COMMON STOCK DIRECT OFFERING

On October 4, 2010, the Company entered into a letter agreement with Rodman & Renshaw, LLC, as exclusive placement agent (the "Placement Agent"), pursuant to which the Placement Agent has agreed to act as placement agent on a best efforts basis in connection with the sale of 3,333,334 shares of the Company's common stock ("Common Stock") together with warrants, exercisable for a six month and five trading day period commencing six months and one day following the closing date, to purchase up to an aggregate of 1,666,667 shares of Common Stock in a registered direct offering.

The Company has agreed to pay the Placement Agent an aggregate fee equal to 5% of the gross proceeds from the sale of shares of Common Stock and related warrants in this offering, plus warrants to purchase 166,667 shares of Common Stock. The placement agent warrants are on substantially the same terms as the purchaser warrants except that the placement agent warrants will have an exercise price equal to \$7.50 per share, or 125% of the public offering price, and an exercise period terminating on July 6, 2013. The Company has also agreed to reimburse the Placement Agent for all out-of-pocket expenses incurred in connection with the offering, which is limited to the lesser of 0.8% of the gross proceeds raised by the Company or \$25,000.

In connection with the offering, the Company and certain holders of the Company's series C convertible preferred stock entered into an amendment agreement, dated as of September 30, 2010, to the securities purchase agreement dated November 27, 2009 among the Company and the purchasers of the Company's series C convertible preferred stock, pursuant to which the parties agreed to amend such purchasers' right to participate in future financings of the Company to exclude from this participation right.



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Also on October 4, 2010, the Company and certain institutional investors entered into a securities purchase agreement, pursuant to which the Company agreed to sell to such investors an aggregate of 3,333,334 shares of Common Stock together with warrants to purchase a total of 1,666,667 shares of Common Stock, for gross proceeds of approximately \$20.0 million. Each purchaser of shares of Common Stock will receive a warrant to purchase a number of shares equal to 50% of the number of shares of Common Stock the purchaser purchases in the offering. The purchase price for each share of Common Stock and the related warrant is \$6.00. Each warrant has an exercise price of \$6.00. Each warrant is subject to anti-dilution provisions that require adjustment of the number of shares of Common Stock that may be acquired upon exercise of the warrant, or to the exercise price of such shares, or both, to reflect stock dividends and splits, subsequent rights offerings, pro-rata distributions, and certain fundamental transactions.

The closing of the offering took place on October 8, 2010. 3,333,334 shares of the Company's common stock were issued to the above-mentioned institutional investors for US\$20,000,000 at \$6 each. Net proceeds after issuance cost were approximately US\$18.8 Million.

2) MATERIAL FIXED ASSETS PURCHASE

Subsequent to September 30, 2010, Research Institute entered into three equipment purchase contracts with Sellers, pursuant to which, Research Center purchased various equipment valued at RMB84,000,000 (equivalent to approximately \$13,000,000).

Note 20. RESTATEMENTS TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 and 2010

The purpose of the restatements is to correct certain classification errors in the condensed consolidated statements of cash flows. Specifically, the Company did not consider the impact of the unpaid amounts relating to property, plant and equipment in preparing the condensed consolidated statements of cash flows for the nine months ended September 30, 2010 and 2009. Secondly, the Company settled purchase obligations due to its equipment vendors using bank acceptance notes the Company received from its customers. The Company reported such transactions as both operating cash inflows and investing cash outflows, instead of non-cash transactions for the nine months ended September 30, 2010 and 2009. Thirdly, during the nine months ended September 30, 2009, the Company settled a related party loan using bank acceptance notes the Company received from its customers. The Company reported such transaction as both operating cash inflows and financing cash outflows, instead of non-cash transactions for the nine months ended September 30, 2009.

The restatement also corrected errors in the calculation of EPS. The Company had not applied the two-class method in the calculation of basic and diluted EPS for the three and nine months ended September 30, 2010 and 2009. After application of the two-class method, the basic and diluted EPS for the nine months ended September 30, 2010 were reduced by \$0.02 per share. The basic EPS for the nine months ended September 30, 2009 was reduced by \$0.02 per share.

In addition, there was a mathematical error in the computation of diluted EPS in which the Company did not deduct the changes in fair values of warrants from net income attributable to common stockholders in the calculation of diluted EPS. After the accounting for the deduction of such changes in fair values of warrants from net income attributable to common stockholders, the diluted EPS for the three months and nine months ended September 30, 2010 were reduced by \$0.01 and \$0.02 per share, respectively.



The impact of the restatements on the respective line items of the condensed consolidated statements of income and other comprehensive income and condensed consolidated statements of cash flows is summarized below.

Condensed Consolidated Statement of Income and Other Comprehensive Income

|                     | Nine-Month Period Ended<br>September, 2010 |                  | Nine-Month Period Ended<br>September 30, 2009 |                  |
|---------------------|--|------------------|---|------------------|
|                     | US\$<br>Restated                           | US\$<br>Original | US\$<br>Restated                              | US\$<br>Original |
| Earnings per share: |  |                  |   |                  |
| Basic               | 0.44                                       | 0.46             | 0.40  | 0.42             |
| Diluted             | 0.41                                       | 0.45             | 0.25  | 0.25             |

Condensed Consolidated Statements of Cash Flows

|  | Nine-Month Period Ended<br>September, 2010 |                  | Nine-Month Period Ended<br>September 30, 2009 |                  |
|--|--|------------------|---|------------------|
|  | US\$<br>Restated                           | US\$<br>Original | US\$<br>Restated                              | US\$<br>Original |
| Cash flows from operating activities:                          |  |                  |   |                  |
| Notes receivables  | (5,795,307)                                | 81,342           | (8,245,792)                                   | 184,153          |
| Accounts payable and other payables                            | 3,128,867                                  | 2,575,121        | 642,993                                       | 554,807          |
| Net cash provided by operating activities                      | 10,104,084                                 | 15,426,987       | 9,853,762                                     | 18,195,521       |
| Cash flows from investing activities:                          |  |                  |   |                  |
| Purchases of property, plant and equipment                     | (983,753)                                  | (6,306,656)      | (468,678)                                     | (1,842,306)      |
| Net cash used in investing activities                          | (658,829)                                  | (5,981,732)      | (468,678)                                     | (1,842,306)      |
| Cash flows from investing activities:                          |  |                  |   |                  |
| Repayment to related parties                                   |  |                  | (360,552)                                     | (7,328,683)      |
| Net cash used in financing activities                          |  |                  | (8,140,704)                                   | (15,108,835)     |
| Non-cash investing and financing activities:                   |  |                  |   |                  |
| Accrual for purchase of property and equipment                 | 1,469                                      | -                | 10,245  | -                |
| Settlement of equipment purchases using bank acceptance notes  | 5,876,649                                  | -                | 1,461,814                                     | -                |
| Settlement of a related party loan using bank acceptance notes | -  | -                | 6,968,131                                     | -                |

Item 2. Management's Discussion and Analysis of Financial Condition and Result of Operations.

We make forward-looking statements in this report, in other materials we file with the Securities and Exchange Commission (the "SEC") or otherwise release to the public, and on our website. In addition, our senior management might make forward-looking statements orally to analysts, investors, the media and others. Statements concerning our future operations, prospects, strategies, financial condition, future economic performance (including growth and earnings) and demand for our products and services, and other statements of our plans, beliefs, or expectations, including the statements contained in this Item 2, "Management's Discussion and Analysis or Plan of Operation," regarding our future plans, strategies and expectations are forward-looking statements. In some cases these statements are identifiable through the use of words such as "anticipate," "believe," "estimate," "expect," "intend," "plan," "project," "target," "could," "may," "should," "will," "would" and similar expressions. We intend such forward-looking statements to be covered by the safe harbor provisions contained in Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and in Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). You are cautioned not to place undue reliance on these forward-looking statements because these forward-looking statements we make are not guarantees of future performance and are subject to various assumptions, risks, and other factors that could cause actual results to differ materially from those suggested by these forward-looking statements. Thus, our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to, changes in: economic conditions generally and the automotive modified plastic market specifically, legislative or regulatory changes that affect our business, including changes in regulation, the availability of working capital, the introduction of competing products, and other risk factors described herein. These risks and uncertainties, together with the other risks described from time-to-time in reports and documents that we filed with the SEC should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Indeed, it is likely that some of our assumptions will prove to be incorrect. Our actual results and financial position will vary from those projected or implied in the forward-looking statements and the variances may be material. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Overview

China XD Plastics Company Limited ("China XD Plastics"), formerly known as NB Telecom, Inc ("NB Telecom") was originally incorporated as NB Payphones Ltd. under the laws of the state of Pennsylvania on November 16, 1999. On December 27, 2005, we migrated our state of organization to the state of Nevada and effective March 23, 2006, our name was changed to NB Telecom.

On December 24, 2008, NB Telecom acquired all of the outstanding capital stock of Favor Sea Limited ("Favor Sea BVI"), a British Virgin Islands corporation, whose assets, held through its subsidiaries, are 100% of the registered capital of Harbin Xinda Macromolecule Material Co., Ltd. ("Harbin Xinda"), a limited liability company established under the laws of the People's Republic of China ("China" or "PRC") and Harbin Xinda's wholly-owned subsidiary, Harbin Xinda Macromolecule Material Research Institute (the "Research Institute") and Harbin Xinda Macromolecule Material Engineering Research Center Company Limited (the "New Research Center").

Harbin Xinda is a manufacturer and developer of modified plastics. We believe that Harbin Xinda is one of the primary modified plastics manufacturers for automotive applications in the PRC, developing and producing made-to-order modified plastics and providing after-sales services to such automotive brands as Audi, Red Flag, VW Golf, and Mazda.



## Results of Operations

Comparing Three Months Ended September 30, 2010 and 2009:

The following table sets forth information from our statements of operations for the three months ended September 30, 2010 and 2009, in dollars:

|  | For the Three Months Ended<br>September 30, |               |
|--|---|---------------|
|  | 2010  | 2009          |
| Sales  | \$ 65,345,883                               | \$ 36,194,459 |
| Cost of Sales  | (49,073,589)                                | (27,777,237)  |
| Gross Profit   | 16,272,294                                  | 8,417,222     |
| Operating Expense  | 3,671,507                                   | 4,095,294     |
| Operating Income   | 12,600,787                                  | 4,321,928     |
| Interest Expense, net                                      | (310,514)                                   | (340,464)     |
| Other Income (Loss) , net                                  | 2,289                                       | (645)         |
| Changes in fair value of warrants and embedded derivatives | 88,064                                      | -             |
| Net Income   | 12,263,077                                  | 3,956,640     |
| Comprehensive Income                                       | \$ 13,534,096                               | \$ 3,937,430  |

## Net sales

During the three months ended September 30, 2010, we had net sales of \$65,345,883, as compared with net sales of \$36,194,459 during the same period in 2009, an increase of \$29,151,424, or 80.5%, due to our increased and expanded sales both in volume and of new variety of products to our existing and new customers as a result of the high market demand supported by our newly acquired production lines in December 2009. The automobile market in China is the primary market for our products, and it continued to expand in the first, second and third quarter of 2010, mainly due to the increasing automobile consumption in China. We continued to capitalize on this growth trend during the third quarter of 2010.

## Cost of Sales and Gross Margin

During the three months ended September 30, 2010, we had cost of sales of \$49,073,589, as compared with cost of sales of \$27,777,237 during the same period in 2009, an increase of approximately \$21,296,352, or 76.7%, reflecting the increase in net sales. The gross profit rose to \$16,272,294 for the three months ended September 30, 2010, or a 93.3% increase compared with \$8,417,222 during the same period in 2009. Our gross margin increased to 24.9% during the three months ended September 30, 2010 from 23.3% during the three months ended September 30, 2009. The increase was mainly attributed to the increased sales of our high-end products as a percentage to total sales in the third quarter of 2010 as a result of our efforts of developing and selling more high value-added automotive modified plastics.

## Operating Expenses

Our operating expenses were \$3,671,507 during the three months ended September 30, 2010, compared with \$4,095,294 during the three months ended September 30, 2009, a decrease of \$423,787, or approximately 10.3%. The decrease in operating expenses was principally due to the decrease of \$2,573,983 in stock-based compensation expense, though principally offset by relocation expense of \$172,950 paid to Harbin Economic and Technological Development Zone Administration pursuant to the District Entry Agreement together with an increase of \$1,456,857

research and development expenses, which reflects our increased efforts in new products development.

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### Interest Expense, Net

Interest expense decreased by \$29,950, or 8.8%, from \$340,464 during the three months ended September 30, 2009 to \$310,514 for the three months ended September 30, 2010. The decrease in interest expense resulted from the decrease in our loans as we repaid some borrowings.

### Change in Fair Value of Warrants and Derivative Liabilities

Change in fair value of warrant and derivative liabilities was an increase of \$88,064 during the three months ended September 30, 2010 as compared to nil for the three months ended September 30, 2009 due to the change of fair value of warrants and embedded conversion feature related to the private placement in December 2009.

### Net Income

Due to the significant increase in our sales and gross margin, and the decrease of stock based compensation costs and expenses, we earned net income of \$12,263,077 during the three months ended September 30, 2010, compared with net income of \$3,956,640 during the three months ended September 30, 2009.

### Comprehensive Income

As a result of the factors described above and a currency translation adjustment, our comprehensive income was \$13,534,096 during the quarter ended September 30, 2010, compared with comprehensive income of \$3,937,430 during the quarter ended September 30, 2009.

### Comparing Nine Months Ended September 30, 2010 and 2009:

The following table sets forth information from our statements of operations for the nine months ended September 30, 2010 and 2009, in dollars:

|  | For the Nine Months Ended<br>September 30, |                    |
|--|--|--------------------|
|  | 2010                                       | 2009<br>(Restated) |
| Sales  | \$ 177,392,985                             | \$ 94,498,615      |
| Cost of Sales  | (134,419,371)                              | (73,656,568)       |
| Gross Profit   | 42,973,614                                 | 20,842,047         |
| Operating Expense  | 23,933,188                                 | 9,925,951          |
| Operating Income   | 19,040,426                                 | 10,916,096         |
| Interest Expense, net                                      | (993,817 )                                 | (1,033,183 )       |
| Other Income, net  | 30,402                                     | 52,012             |
| Changes in fair value of warrants and embedded derivatives | 4,496,950                                  | -                  |
| Net Income   | 22,389,061                                 | 9,904,284          |
| Comprehensive Income                                       | \$ 24,205,590                              | \$ 9,857,678       |

#### Net sales

During the nine months ended September 30, 2010, we had net sales of \$177,392,985, as compared with net sales of \$94,498,615 during the same period in 2009, an increase of \$82,894,370, or 87.7%, due to our increased and expanded sales both in volume and of new variety of products to our existing and new customers as a result of the high market demand supported by our newly acquired production lines in December 2009. The automobile market in China, especially the market for small to medium engine automobiles which is the primary market for our products, continued to expand in the first, second and third quarter of 2010, mainly due to the increasing automobile consumption in China. We capitalized on this growth trend during the nine months of 2010.

#### Cost of Sales and Gross Margin

During the nine months ended September 30, 2010, we had cost of sales of \$134,419,371, as compared with cost of sales of \$73,656,568 during the same period in 2009, an increase of approximately \$60,762,803, or 82.5%, reflecting the increase in net sales. The gross profit rose to \$42,973,614 for the nine months ended September 30, 2010, or a 106.2% increase compared with \$20,842,047 during the same period in 2009. Our gross margin had a decrease of 2.1% during the nine months ended September 30, 2010 from 22.1% during the nine months ended September 30, 2009 to 24.2% of the nine months ended September 30, 2010. The decrease was mainly attributed to the increased price of raw materials, despite sales of our high-end, higher margin products as a percentage to total sales, as a result of our efforts in developing and selling more high value-added automotive modified plastics.

#### Operating Expenses

Our operating expenses were \$23,933,188 during the nine months ended September 30, 2010, compared with \$9,925,951 during the nine months ended September 30, 2009, an increase of \$14,007,237, or approximately 141.1%. The increase in operating expenses was principally due to the increase in the non-cash expense of option arrangement and stock-based compensation expense, and research and development expense.

Non-cash expense of option arrangement and stock-based compensation expenses increased from \$6,256,818 during the nine months ended September 30, 2009 to \$14,730,213 for the nine months ended September 30, 2010, including non-cash stock compensation expense of options granted to Mr. Han of \$13,355,832 and \$3,065,388, respectively, for the nine months ended September 30, 2010 and 2009. Research and development expenses increased \$4,303,072, or 495.6%, from \$868,252 during the nine months ended September 30, 2009 to \$5,171,324 during the same period in 2010, reflecting our increased efforts in new products development.

#### Interest Expense, Net

Interest expense decreased by \$39,366, or 3.8%, from \$1,033,183 during the nine months ended September 30, 2009 to \$993,817 for the nine months ended September 30, 2010. The decrease in interest expense resulted from the decrease in our loans, as we repaid some borrowings.

#### Change in Fair Value of Warrants and Derivative Liabilities

Change in fair value of warrant and derivative liabilities was a decrease of \$4,496,950 during the nine months ended September 30, 2010 as compared to nil for the nine months ended September 30, 2009, due to the change of fair value of warrants and embedded conversion feature related to the private placement in December 2009.

#### Net Income

Due to the significant increase in our sales and gross margin, and despite the increase of stock based compensation expenses, our net income increased to \$22,389,061 during the nine months ended September 30, 2010, compared with \$9,904,284 during the nine months ended September 30, 2009. This increase in net income was mainly attributable to the increase of our operating income of \$8,124,330, and non-cash fair value gain of \$4,496,950 on warrants and derivative liabilities related to the private placement in December 2009.

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## Comprehensive Income

As a result of the factors described above and a currency translation adjustment, our comprehensive income was \$24,205,590 during the nine months ended September 30, 2010, compared with \$9,857,678 during the nine months ended September 30, 2009.

## Liquidity and Capital Resources

As of September 30, 2010, we had \$15,475,824 in cash and cash equivalents, compared to \$6,850,784 as of December 31, 2009. There was an increase in cash and cash equivalents of \$8,625,040. The net increase in cash and cash equivalents for the period was mainly due to cash provided by operations, more specifically, the increase in net income and accounts payable and other payables partially offset by the increase in inventory, advances to suppliers, accounts and other receivables.

## Operations

For the nine months ended September 30, 2010, cash provided by operations was \$10,104,084, compared to cash provided by operations of \$9,853,762 for the same period in 2009. The primary reason for the change was mainly due to the increase in net income and accounts payable, principally offset by the increase in inventory, advances to suppliers, accounts and other receivables.

## Investments

Cash used in investing activities was \$658,829 for the nine months ended September 30, 2010 as compared to cash used in investing activities of \$468,678 for the nine months ended September 30, 2009 as we incurred more construction in progress in Research Institute this year to achieve our target of expanding our business by over 30% in 2011.

## Financing

For the nine months ended September 30, 2010, net cash used in financing activities was \$1,095,011 as compared to net cash used in financing activities of \$8,140,704 for the same period in 2009. Decrease in cash used in financing activities was mainly due to repayment of our bank acceptance notes payable, short-term loans and related party loans which were used to fund the rapid growth in our business.

Based on past performance and current expectations, we believe our cash and cash equivalents and cash generated from operations will satisfy our working capital needs, capital expenditures and other liquidity requirements associated with our operations for at least the next 12 months.

The majority of our revenues and expenses are denominated primarily in Renminbi (“RMB”), the currency of the People’s Republic of China. There is no assurance that exchange rates between the RMB and the U.S. Dollar will remain stable. We do not engage in currency hedging. Inflation has not had a material impact on our business.

## Off-Balance Sheet Arrangements

Neither us, nor any of our subsidiaries has any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition or results of operations.

## Critical Accounting Policies

This section should be read together with the Summary of Significant Accounting Policies included as Note 2 to the consolidated financial statements included in our Annual Report on Form 10-K for 2009 filed with the SEC.

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## Principles of Consolidation

The consolidated financial statements for the nine months ended September 30, 2010 and 2009 include the accounts of China XD Plastics, Favor Sea (BVI), Favor Sea (US), HK Engineering Plastics, Harbin Xinda and the Research Institute. The consolidated financial statements for the nine months ended September 30, 2010 also include the accounts of the New Research Center. They are collectively referred to as the “Company”. The Company’s consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“US GAAP”). All significant inter-company balances and transactions are eliminated in consolidation.

## Allowance for Doubtful Receivables

The Company recognizes an allowance for doubtful receivables to ensure accounts and other receivables are not overstated due to uncollectability. Allowance for doubtful receivables is maintained for all customers based on a variety of factors, including the length of time the receivables are past due, significant one-time events and historical experience. An additional allowance for individual accounts is recorded when the Company becomes aware of a customer’s or other debtor’s inability to meet its financial obligation, such as in the case of bankruptcy filings or deterioration in the customer’s or other debtor’s operating results or financial position. If circumstances related to customers or debtors change, estimates of the recoverability of receivables would be further adjusted.

## Revenue Recognition

The Company’s revenue recognition policies are in compliance with Staff Accounting Bulletin No. 101, as revised by No.104, issued by SEC, which is now codified as FASB ASC 605. In accordance with FASB ASC 605, revenues are recognized when the four following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) the delivery is completed, (iii) the fees are fixed or determinable, and (iv) collectability is reasonably assured.

Revenue from sales of products is recognized when the title is passed to customers upon delivery and when collectability is reasonably assured. The Company does not provide its customers with the right of return (except for quality). All sales are based on firm customer orders with fixed terms and conditions, which generally cannot be modified.

## Inventories

Inventories comprise raw materials, packing materials, work in process and finished goods. Inventories are valued at the lower of cost or market with cost determined by the weighted average method. Management periodically compares the cost of inventories with the market value and an allowance is made for writing down the inventories to their market value, if lower than cost. No allowance for inventories is considered necessary for the nine months ended September 30, 2010 and 2009.

## Stock Based Compensation

The Company adopted Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) No. 718 in the second quarter of 2009, at which time the Company began recognizing an expense for unvested share-based compensation that has been issued or will be issued after that date. The Company adopted ASC No. 718 on a prospective basis.

The Company estimates fair value of restricted stock based on the number of shares granted and the quoted price of the Company’s common stock on the date of grant. The fair value of warrants is estimated using the Black-Scholes model. The Company’s expected volatility assumption is based on the historical volatility of the Company’s stock. The

risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The Company measures compensation expense for its non-employee stock-based compensation under ASC No. 718.

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The fair value of the stock issued is used to measure the transaction, as this is more reliable than the fair value of the services received. Fair value is measured as the value of the Company's common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty's performance is complete. The fair value of the equity instrument is charged directly to compensation expense and additional paid-in capital.

Stock compensation expense recognized is based on awards expected to vest. ASC No. 718 requires forfeitures to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates. The current options outstanding were only issued to founders and senior executives of the Company, which have very low turnover; therefore, there are no estimated forfeitures for these options.

#### Accounting for the Series C preferred stock

The Series C preferred stock is mandatorily redeemable on December 1, 2012, at a conversion amount equal to the stated value plus the additional amount. The additional amount is a formula based on the 6% dividend rate and the time that the preferred stock is outstanding. The Company uses the guidance of FASB ASC 480-10-S99, "Distinguishing Liabilities from Equity", which states that equity instruments with redemption features that are not solely within the control of the issuer to be classified temporary equity. The Company's Series C preferred stock is contingently redeemable as it is convertible until the end of the third anniversary.

#### Accounting for Embedded Conversion Feature

The Company applied FASB ASC 815 to account for the embedded conversion features related to our Series C preferred stock. The embedded conversion feature is a derivative that must be bifurcated from the host instrument and accounted for at fair value with changes in fair value recorded in earnings.

#### Accounting for Warrants

The Company analyzed the warrants issued in the December 2009 financing in accordance with FASB ASC 815, to determine whether the warrants meet the definition of a derivative and, if so, whether the warrants meet the scope exception of FASB ASC 815, which is that contracts issued or held by the reporting entity that are both (1) indexed to its own stock and (2) classified in stockholders' equity shall not be considered to be derivative instruments for purposes of FASB ASC 815.

The Company also considered the provisions of EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock" which is now codified as FASB ASC 815-40, and which applies to any freestanding financial instruments or embedded features that have the characteristics of a derivative, as defined by FASB ASC 815, and to any freestanding financial instruments that are potentially settled in an entity's own common stock.

As a result of its interpretation of FASB ASC 815-40, the Company concluded that the warrants should be treated as a derivative liability because the warrants are entitled to a price adjustment provision to allow the exercise price to be reduced in the event the Company issues or sells any additional shares of common stock at a price per share less than the then-applicable exercise price or without consideration, which is typically referred to as a "Down-round protection" or "anti-dilution" provision. According to FASB ASC 815-40, the "Down-round protection" provision is not considered to be an input to the fair value of a fixed-for-fixed option on equity shares which leads the warrants to fail to be qualified as indexed to the Company's own stock and then to fail to meet the scope exceptions of FASB ASC 815. Therefore, the Company accounted for the warrants as derivative liabilities under FASB ASC 815. Pursuant to FASB ASC 815, derivatives are measured at fair value and re-measured at fair value with changes in fair value recorded in earnings at each reporting period.



## Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standard Update No.2010-06 (“ASU 2010-06”), “Improving Disclosures about Fair Value Measurements”, which amends ASC 820 to add new requirements for disclosures related to amounts transferred into and out of Level 1 and 2 fair value measurements as well as separate disclosures of purchases, sales, issuances, and settlements related to amounts reported as Level 3 fair value measurements. ASU 2010-06 also clarifies existing fair value disclosure requirements related to the level of disaggregation and the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This guidance has been effective since the quarter ended March 31, 2010, except for the separate disclosures of purchases, sales, issuances, and settlements related to amounts reported as Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010.

The adoption of this guidance did not have a material impact on its results of operations or cash flows.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

## Item 4T. Controls and Procedures.

### Evaluation of Disclosure Controls and Procedures

The Company’s management has evaluated, under the supervision and with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operations of the Company’s disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e) and 15d-15(e)), as of the end of the period covered by this report. Based on this evaluation, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective because of weaknesses in our internal control over financial reporting as disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

The material weaknesses could result in a misstatement of the aforementioned accounts or disclosures that might result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. However, giving full consideration to these material weaknesses, we performed adequate analyses and procedures, including among other things, and in addition to the remediation initiatives the Company has implemented as identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, transaction reviews and account reconciliations in order to provide assurance that our unaudited consolidated financial statements included in this Quarterly Report were prepared in accordance with generally accepted accounting principles (“GAAP”) and present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP. As a result of these procedures, we concluded that the unaudited consolidated financial statements included in this Quarterly Report present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

### Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the fiscal quarter ended September 30, 2010 covered by the Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.





## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings.

None.

### Item 1A. Risk Factors.

As of the date of this filing, there have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K filed on April 14, 2010. We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially affect our operations. The risks, uncertainties and other factors set forth in our Annual Report on Form 10-K may cause our actual results, performances and achievements to be materially different from those expressed or implied by our forward-looking statements. If any of these risks or events occurs, our business, financial condition or results of operations may be adversely affected.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

### Item 3. Defaults Upon Senior Securities.

None.

### Item 4. (Removed and Reserved).

### Item 5. Other Information.

None.

### Item 6. Exhibits.

| Exhibit No. | Description  |
|-------------|--|
| 4.1         | Form of Common Stock Purchase Warrant (1)  |
| 10.1        | Letter Agreement, dated October 4, 2010, between China XD Plastics Company Limited and Rodman & Renshaw, LLC (1)   |
| 10.2        | Securities Purchase Agreement dated October 4, 2010, among China XD Plastics Company Limited and certain institutional investors (1)   |
| 10.3        | Amendment Agreement, dated as of September 30, 2010, to the Securities Purchase Agreement dated November 27, 2009 among China XD Plastics Company Limited and the purchasers named therein (1) |
| 10.4        | Service Agreement effective as of October 4, 2010 between China XD Plastics Company Limited and Robert Brisotti (2)  |
| 10.5        | Service Agreement dated May 14, 2009 between China XD Plastics Company Limited and Cosimo J. Patti (2)   |
| 10.6        | Separation and Release Agreement dated September 30, 2010 between China XD Plastics Company Limited and Cosimo J. Patti (2)  |
| 31.1        | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.  |
| 31.2        |  |

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Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.

- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 6, 2010.

(2) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 7, 2010.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

China XD Plastics Company  
Limited

Date: November 2, 2011

/s/ Jie Han  
Jie Han  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 2, 2011

/s/ Taylor Zhang  
Taylor Zhang  
Chief Financial Officer  
(Principal Accounting and  
Financial Officer)

Exhibit Index

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