Recon Technology, Ltd
Form 10-Q
May 15, 2014

U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2014

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ______ to ______.

Commission File Number 001-34409

RECON TECHNOLOGY, LTD

(Exact name of registrant as specified in its charter)

Cayman Islands **Not Applicable**

(State or other jurisdiction of (I.R.S. employer

incorporation or organization) identification number)

1902 Building C, King Long International Mansion

No. 9 Fulin Road

Beijing 100107 China

(Address of principal executive offices and zip code)

+86 (10) 8494-5799

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

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

Indicate the number of shares outstanding of each of the issuer's classes of ordinary shares, as of the latest practicable date. The Company is authorized to issue 25,000,000 ordinary shares. As of the date of this report, the Company has issued and outstanding 4,620,936 shares.

RECON TECHNOLOGY, LTD

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Special Note Regarding Forward-Looking Statements

This document contains certain statements of a forward-looking nature. Such forward-looking statements, including but not limited to projected growth, trends and strategies, future operating and financial results, financial expectations and current business indicators are based upon current information and expectations and are subject to change based on factors beyond the control of the Company. Forward-looking statements typically are identified by the use of terms such as "look," "may," "should," "might," "believe," "plan," "expect," "anticipate," "estimate" and similar words, although som forward-looking statements are expressed differently. The accuracy of such statements may be impacted by a number of business risks and uncertainties that could cause actual results to differ materially from those projected or anticipated, including but not limited to the following:

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

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

Part I Financial Information

Item 1. Financial Statements.

See the unaudited condensed consolidated financial statements following the signature page of this report, which are incorporated herein by reference.

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

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

Overview

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

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

Our VIEs provide the oil and gas industry with equipment, production technologies, automation and services.

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

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

Products and Services

We provide the following three types of integrated products and services for our customers.

Equipment for Oil and Gas Production and Transportation

High-Efficiency Heating Furnaces. Crude petroleum contains certain impurities that must be removed before it can be sold, including water and natural gas. To remove the impurities and to prevent solidification and blockage in transport pipes, companies employ heating furnaces. BHD researched, developed and implemented a new oilfield furnace that is advanced, highly automated, reliable, easily operable, safe and highly heat-efficient (90% efficiency).

Burner. We serve as an agent for the Unigas Burner, which is designed and manufactured by UNIGAS, a European burning equipment production company. The burner we provide has the following characteristics: high degree of automation, energy conservation, high turn-down ratio, high security and environmental safety.

Oil and Gas Production Improvement Techniques

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

Production Packer. At varying withdrawal points, the production packer separates different oil layers and protects the oil pipe from sand and permeation, promoting the recovery ratio.

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

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

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

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

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

Automation System and Services

Pumping Unit Controller. This controller functions as a monitor to the pumping unit and also collects data for load, pressure, voltage, and startup and shutdown control.

RTU Monitor. This monitor collects gas well pressure data.

Wireless Dynamometer and Wireless Pressure Gauge. These products replace wired technology with cordless displacement sensor technology. They are easy to install and significantly reduce the work load associated with cable laying.

Electric Multi-way Valve for Oilfield Metering Station Flow Control. This multi-way valve is used before the test separator to replace the existing three valve manifolds. It facilitates the electronic control of the connection of the oil lead pipeline with the separator.

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

Recon Supervisory Control and Data Acquisition System (“SCADA”). Recon SCADA is a system which applies to the oil well, measurement station, and the union station for supervision and data collection.

EPC Service of Pipeline SCADA System. This service technique is used for pipeline monitoring and data acquisition after crude oil transmission.

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

EPC Service of Oilfield Video Surveillance and Control System. This video surveillance technique is used for controlling the oil and gas wellhead area and the measurement station area.

Technique Service for “Digital oilfield” Transformation. This service includes engineering technique services such as oil and gas SCADA system, video surveillance and control system and communication systems.

Factors Affecting Our Business

Business Outlook

The oilfield engineering and technical service industry is generally divided into five sections: (1) exploration, (2) drilling and completion, (3) testing and logging, (4) production, and (5) oilfield construction. Thus far our businesses have been involved in completion, production and construction processes. Our management still believes we need to expand our core business, move into new markets, and develop new businesses quickly for the coming years. Management anticipates great opportunities both in new markets and our existing markets. We believe that many existing wells and oilfields need to improve or renew their equipment and service to maintain production and techniques and services like ours will be needed as new oil and gas fields are developed. In the next three years, we will focus on:

Measuring Equipment and Service. “Digital oil field” and the management of oil companies are highly regarded. We believe our oilfield SCADA and related technical support services will address the needs of the oil well automation system market, for which we forecast strong needs in the short term. In addition, through early cooperation with CNPC in Turkmenistan, we have developed our experience in this market. Although bidding has not yet commenced , we will continue pursuing overseas business projects in the coming second phase construction, which we expect to occur in 2014.

Gathering and Transferring Equipment. With more new wells developed, our management anticipates that demand for our furnaces and burners will grow more compared to last year, especially in the Jilin Oilfield and Zhongyuan oilfield.

Fracturing service. We believe we cooperated well with Zhongyuan Oilfield in fiscal year 2013 and expect to continue growing revenue from fracturing and related stimulation services for fiscal year 2014, from Zhongyuan oilfield and also some other oilfields clients.

New product line. Design and development of down-hole tools has always been an important technique for oilfield companies. Recently, this market has developed very rapidly. After a year test project for our customers, we have developed experience with this technology and our customers have accepted our products and services. We expect revenue from this business in fiscal year 2014.

Growth Strategy

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

Large domestic oil companies have historically focused on their exploration and development businesses to earn higher margins and keep their competitive advantage. With regard to private oilfield service companies, we estimate that approximately 90% specialize in the manufacture of drilling and production equipment. Thus, the market for technical support and project service is still in its early stage. Our management insists on providing high quality products and service in oilfields in which we have a geographical advantage. This will allow us to avoid conflicts of interest with bigger suppliers of drilling equipment and protect our position within the market segment. Our mission is to increase the automation and safety levels of industrial petroleum production in China and improve the underdeveloped working process and management mode by using advanced technologies. At the same time, we are always looking to improve our business and to increase our earning capability.

Industry and Recent Developments

Despite uncertainty in the energy industry related to such matters as fluctuating prices and future opportunities for oil companies, our management believes there are still many factors to support our long-term development:

The opening of the Chinese oil industry to participation by non-state owned service providers and vendors played an increasingly important role in the high-end oilfield service segment to allow competition based on efficiency and price. As oil and gas fields are depleted, it becomes more challenging to find and convert reserves into usable energy sources. As the industry has permitted competition by private companies and oil companies have formed separate service companies, high-tech service has gradually opened up to private companies.

Overseas assets of Chinese oilfield companies increased gradually, and they will provide more opportunity for domestic service companies to participate in foreign projects.

Management is focused on these factors and will seek to extend our business on the industrial chain, like providing more integrated services and incremental measures and growing our business from a predominantly up-ground business to include some down-hole services as well.

Factors Affecting Our Results of Operations

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

- the amount of spending by our customers, primarily those in the oil and gas industry;
- growing demand from large corporations for improved management and software designed to achieve such corporate performance;
- the procurement processes of our customers, especially those in the oil and gas industry;
- competition and related pricing pressure from other oilfield service solution providers, especially those targeting the Chinese oil and gas industry;
- the ongoing development of the oilfield service market in China; and
- inflation and other macroeconomic factors.

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

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

- our revenue growth, in terms of the proportion of our business dedicated to large companies and our ability to successfully develop, introduce and market new solutions and services;
- our ability to increase our revenues from both old and new customers in the oil and gas industry in China;
- our ability to effectively manage our operating costs and expenses; and
- our ability to effectively implement any targeted acquisitions and/or strategic alliances so as to provide efficient access to markets and industries in the oil and gas industry in China.

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Critical Accounting Policies and Estimates

Estimates and Assumptions

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

Consolidation of VIEs

We recognize an entity as a VIE if it either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. We consolidate a VIE as its primary beneficiary when we have both the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. We perform ongoing assessments to determine whether an entity should be considered a VIE and whether an entity previous identified as a VIE continues to be a VIE and whether we continue to be the primary beneficiary.

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

Revenue Recognition

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

Hardware

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

Services

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

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

Fair Values of Financial Instruments

The US GAAP accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The three levels of inputs are defined as follows:

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

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

Level 3 inputs to the valuation methodology are unobservable.

The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, advances to suppliers, trade accounts payable, accrued liabilities, advances from customers and notes payable approximate fair value because of the immediate or short-term maturity of these financial instruments. Long-term receivables and borrowings approximate fair value because their interest rates charged approximate the market rates for financial instruments with similar terms. The fair value of the warrants liability was determined using the Black-Scholes Model, as Level 2 inputs (See Note 13). Any changes in the assumptions that are used in the Black-Scholes Model may increase or decrease the warrants liability from quarter to quarter. Any change in adjustment would be charged to operations.

Receivables

Trade receivables are carried at original invoiced amount less a provision for any potential uncollectible amounts. Provisions are applied to trade receivables where events or changes in circumstances indicate that the balance may not be collectible. The identification of doubtful accounts requires the use of judgment and estimates of management. Our management must make estimates of the collectability of our accounts receivable. Management specifically analyzes accounts receivable, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We believe based on the current economic condition and our history of collections on accounts and notes receivable, our allowance for doubtful accounts was adequate at March 31, 2014.

Valuation of Long-Lived Assets

We review the carrying values of our long-lived assets for impairment whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, we project undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, we reduce the carrying value of the long-lived asset by the estimated excess of the carrying value over the projected discounted cash flows. In the past, we have not had to make significant adjustments to the carrying values of our long-lived assets, and we do not anticipate a need to do so in the future. However, circumstances could cause us to have to reduce the value of our capitalized assets more rapidly than we have in the past if our revenues were to significantly decline. Estimated cash flows from the use of the long-lived assets are highly uncertain and therefore the estimation of the need to impair these assets is reasonably likely to change in the future. Should the economy or acceptance of our assets change in the future, it is likely that our estimate of the future cash flows from the use of these assets will change by a material amount. There were no impairments at June 30, 2013 and March 31, 2014.

Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC Topic 718, Share-Based Payment. Under the fair value recognition provisions of this topic, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense with graded vesting on a straight–line basis over the requisite service period for the entire award. The Company has elected to recognize compensation expenses mainly using the Black-Scholes valuation model estimated at the grant date based on the award's fair value.

Results of Operations

Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013

Revenues

	For the Three Months Ended March 31,				
	2013	2014	Increase / (Decrease)	Percentage Change	
Hardware -non-related parties	¥4,161,583	¥17,763,602	¥13,602,019	326.8	%
Hardware - related parties	1,028,606	94,446	(934,160)	(90.8	)%
Service	62,678	80,180	17,502	27.9	%
Software-non-related parties	-	234,842	234,842	100	%
Software - related parties	2,248,928	59,400	(2,189,528)	(97.4	)%
Total revenues	¥7,501,795	¥18,232,470	¥10,730,675	143.0	%

Revenues. Our revenues increased by 143%, or approximately ¥10.7 million ($1.7 million), from approximately ¥7.5 million for the three months ended March 31, 2013 to ¥18.2 million ($3 million) for the same period of 2014. The changes in our revenues for the three-month period were due to the following factors:

(1) Hardware business. During the three-month ended March 31, 2014, the increase in hardware revenue was mainly caused by higher sales of automation business from the Southwest branch of Sinopec and sales of furnaces to the Jilin Oilfield.

(2) Hardware – related parties. Sales of hardware to related parties decreased due to the reclassification of revenue from related party hardware revenue to non-related party hardware revenue. After we achieved business entrance certification in the name of Recon and could cooperate with oilfield customers directly two years ago, we no longer required the services of a related party with such certification and, accordingly, revenue from related-parties decreased. So long as the local agency still purchases automation products from Recon, we will continue to recognize revenue from related parties, but we anticipate that such hardware and software related party revenue is likely to fluctuate from year to year.

(3) Service business. Service revenue for three months ended March 31, 2013 and 2014 consisted mainly of minor maintenance services, which were provided upon request by customers.

(4) Software business. The software sales to non-related parties increased approximately ¥0.2 million ($38,000). We record revenue as software sales if (1) the customer signs a separate software contract with us, or (2) the customer accepts VAT invoices for software. The amount of our revenues categorized as software sales may fluctuate because certain software may be sold with hardware at times as a whole product and not separately priced.

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(5) Software business – related parties. During the quarter ended March 31, 2014, we recorded software revenue of ¥59,400 ($9,640) to a related party. As mentioned above, we used to develop our Ji Dong oilfield business through a local agent that is a related party. Since we achieved business entrance certification by ourselves and could thus directly compete for projects, revenue through this related party decreased overall. So Software revenue from related party also decreased during this period.

Cost and Margin

	For the Three Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues	¥7,501,795	¥18,232,470	¥10,730,675	143.0 %
Cost of revenues	3,346,344	12,987,514	9,641,170	288.1 %
Gross profit	¥4,155,451	¥5,244,956	¥1,089,505	26.2 %
Margin %	55.4 %	28.8 %	(26.6)%	__

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

Our cost of revenues increased from approximately ¥3.3 million in the three months ended March 31, 2013 to approximately ¥13.0 million ($2.1 million) for the same period of 2014, an increase of approximately ¥9.6 million ($1.6 million), or 288.1%. This increase was mainly caused by higher revenue during the three months ended March 31, 2014 compared to the same period of 2013. As a percentage of revenues, our cost of revenues increased from 44.6% in 2013 to 71.2% in 2014, largely due to increased hardware sales, which feature higher cost of revenues, than service or software revenues.

Gross profit. Our gross profit increased to approximately ¥5.2 million ($0.9 million) for the three months ended March 31, 2014 from approximately ¥4.2 million for the same period in 2013. Our gross profit as a percentage of revenue decreased to 28.8% for the three months ended March 31, 2014 from 55.4% for the same period in 2013. This was mainly due to increased hardware revenue with lower gross profit margins during the three months ended March 31, 2014 as compared to the same period last year where we had higher software revenue with higher gross margins during the three months ended March 31, 2013.

In more detail:

	For the Three Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues-hardware and software- non related parties	¥4,161,583	¥17,998,444	¥13,836,861	332.5 %
Cost of revenues -hardware and software- non related parties	2,527,534	12,848,136	10,320,602	408.3 %
Gross profit	¥1,634,049	¥5,150,308	¥3,516,259	215.2 %
Margin %	39.3 %	28.6 %	(10.7)%	__

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The revenue increase from hardware and software to non-related parties of ¥13.8 million was mainly due to the increase from the furnaces sales and automation business in the three months ended March 31, 2014. The gross profit from the hardware and software sales to non-related parties increased ¥ 3.5 million ($0.6 million) compared to the same period of last year.

	For the Three Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues-hardware and software- related parties	¥3,277,534	¥153,846	¥(3,123,688)	(95.3)%
Cost of revenues -hardware and software - related parties	798,190	97,217	(700,973)	(87.8)%
Gross profit	¥2,479,344	¥56,629	¥(2,422,715)	(97.7)%
Margin %	75.6%	36.8%	(38.8)%	__

Cost of revenue from hardware and software-related parties decreased as revenue decreased. While gross profit decreased was mainly because revenue decreased as we developed business directly with oilfield, rather than cooperation with some parties.

	For the Three Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues-service	¥62,678	¥80,180	¥ 17,502	27.9%
Cost of revenues -service	20,620	42,161	21,541	104.5%
Gross profit	¥42,058	¥38,019	¥ (4,039)	(9.6)%
Margin %	67.1%	47.4%	(19.7)%	__

Service revenue for three months ended March 31, 2013 and 2014 consisted mainly of minor maintenance services, which were provided upon request by customers. There was no fracturing project completed for this period, so no revenue from fracturing service was recorded.

Operating Expenses

	For the Three Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Selling and distribution expenses	1,790,199	1,097,549	(692,650)	(38.7)%

% of revenue	23.9	%	6.0	%	(17.9	)%	__	
General and administrative expenses	3,966,782		3,993,341		26,559		0.7	%
% of revenue	52.9	%	21.9	%	(31.0	)%	__	
Research and development expenses	552,645		720,956		168,311		30.5	%
% of revenue	7.4	%	4.0	%	(3.4	)%	__	
Operating expenses	¥6,309,626		¥5,811,846		¥(497,780	)	(7.9	)%

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Selling and distribution expenses. Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing organization, sales commissions, costs of our marketing programs including advertising and trade shows, and an allocation of our facilities and depreciation expenses. Selling expenses decreased by 38.7%, from approximately ¥1.8 million for the three months ended March 31, 2013 to approximately ¥1.1 million ($0.2 million) for the same period of 2014. This decrease was primarily from decreased traveling expenses, bidding fees, salaries and maintenance expenses. Selling expenses were 23.9% of total revenues in the three months ended March 31, 2013 and 6% of total revenues in the same period of 2014.

General and administrative expenses. General and administrative expenses consist primarily of costs in human resources, facilities costs, depreciation expenses, professional advisor fees, audit fees, option expenses stock based comprehensive expense and other misc. expenses incurred in connection with general operations. General and administrative expenses were flat at ¥4.0 million ($0.6 million) for the three months ended March 31, 2013 and 2014.

Research and development ("R&D") expenses. Research and development expenses consist primarily of salaries and related expenditures of our research and development projects. Research and development expenses increased by 30.5%, from approximately ¥0.6 million for the three months ended March 31, 2013 to approximately ¥0.7 million ($0.1 million) for the same period of 2014. This increase was primarily due to higher input of materials and equipment of R&D on our furnace services.

Net Income

	For the Three Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Loss from operations	¥(2,154,175)	¥(566,890)	¥(1,587,285)	73.7%
Interest and other income (expense)	752,933	(1,092,510)	(1,845,443)	(245.1)%
Loss before income tax	(1,401,242)	(1,659,400)	258,158	18.4%
Provision (benefit) for income tax	(152,382)	150,787	303,169	199.0%
Net loss	(1,248,860)	(1,810,187)	561,327	44.9%
Less: Net income attributable to non-controlling interest	(2,127)	120,415	122,542	5,761.3%
Net loss attributable to ordinary shareholders	¥(1,246,733)	¥(1,930,602)	¥683,869	54.9%

Loss from operations. Loss from operations was approximately ¥0.6 million ($0.1 million) for the three months ended March 31, 2014, compared to loss of ¥2.2 million for the same period of 2013. This decrease in loss from operations can be attributed primarily to the increased revenue, gross margins and decreases in research and development expenses.

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Interest and other income (expense). Interest and other expense was approximately ¥1.1 million ($0.2 million) for the three months ended March 31, 2014, compared to interest and other income of ¥0.8 million for the same period of 2013. The ¥1.8 million ($0.3 million) decrease in interest and other income was primarily due to changes in the fair value of warrant liability ,, a decrease in subsidy income and an increase in loss from investment, offset by a decrease in interest expense.

Investment loss. The Company held approximately 24.4% interest of Avalon at March 31, 2014. Since Avalon's operating results for three months ended March 31, 2014 will not be available as of the filing date, the Company used Avalon's last quarter's operating results as the best estimate for the three months ended March 31, 2014, which was a loss of approximately ¥0.1 million ($22,000).

Provision (benefit) for income tax. Benefit for income tax for the three months ended March 31, 2013 was approximately ¥0.2 million and provision for income tax was ¥0.2 million ($24,000) for the three months ended March 31, 2014. This increase of provision for income tax was mainly due to the pre-consolidation income from operations in subsidiaries in China on which we must pay income tax notwithstanding consolidated losses from operations for the three months ended March 31, 2014.

Net loss. As a result of the factors described above, net loss was approximately ¥1.8 million ($0.3 million) for the three months ended March 31, 2014, an increase of approximately ¥0.6 million ($0.1 million) from net loss of ¥1.2 million for the same period of 2013.

Net loss attributable to ordinary shareholders. As a result of the factors described above, net loss attributable to ordinary shareholders was approximately ¥1.9 million ($0.3 million) for the three months ended March 31, 2014, an increase of approximately ¥0.7 million ($0.1 million) from net loss attributable to ordinary shareholders of ¥1.2 million for same period of 2013.

Nine Months Ended March 31, 2014 Compared to Nine Months Ended March 31, 2013

Revenues

For the Nine Months Ended March 31,			
		Increase /	Percentage
2013	2014	(Decrease)	Change

Hardware -non-related parties	¥30,766,627	¥67,628,886	¥36,862,259	119.8 %
Hardware - related parties	2,273,504	769,231	(1,504,273)	(66.2)%
Service	20,567,637	477,769	(20,089,868)	(97.7)%
Software – non-related parties	5,192,712	5,708,699	515,987	9.9 %
Software - related parties	3,736,107	1,426,921	(2,309,186)	(61.8)%
Total revenues	¥62,536,587	¥76,011,506	¥13,474,919	21.5 %

Revenues. Our revenues increased by 21.5%, or approximately ¥13.5 million ($2.2 million), from ¥62.5 million for the nine months ended March 31, 2013 to ¥76.0 million ($12.3 million) for the same period of 2014. The changes in our revenues for the nine-month period were due to the following factors:

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(1) Hardware business. During the nine-month ended March 31, 2014, the increase in hardware revenue was mainly due to higher sales of furnaces and automation products .

(2) Hardware – related parties. Sales of hardware from related parties decreased because we used to develop business on Ji Dong oilfield through some local agent companies. After we achieved business entrance certification in the name of Recon and could cooperate with oilfield customers directly two years ago, revenue from related-parties decreased, while the local agency might still purchase automation products from Recon, there would be always revenue from related parties and the revenue of both hardware and software from related parties might fluctuate from year to year.

(3) Service business. Service revenue for nine months ended March 31, 2014 consisted mainly of minor maintenance services, which were provided upon request by customers. Our fracturing business is still proceeding, and we also obtained new contracts of this business. In addition, we successfully achieved access certification of other oilfield branches, which means we can provide our fracturing services to a broader customer base. The ¥20.6 million service revenue in the nine months ended March 31, 2013 was mainly due to several fracturing service contracts signed with Sinopec Zhongyuan oilfield.

(4) Software business. The software sales increased approximately ¥0.5 million ($0.1 million). We record revenue as software sales if (1) the customer signs a separate software contract with us, or (2) the customer accepts VAT invoices for software. The amount of our revenues categorized as software sales may fluctuate because certain software may be sold with hardware at times as a whole product and not separately priced

(5) Software business – related parties. In the nine months ended March 31, 2014, we recorded software revenue of ¥1.4 million ($0.2 million) to a related party, a decrease of ¥2.3 million ($0.4 million) from the same period of last year.

Cost and Margin

	For the Nine Months Ended March 31,							
	2013		2014		Increase		Percentage Change	
Total revenues	¥62,536,587		¥76,011,506		¥13,474,919		21.5	%
Cost of revenues	41,915,938		48,951,038		7,035,100		16.8	%
Gross profit	¥20,620,649		¥27,060,468		¥6,439,819		31.2	%
Margin %	33.0	%	35.6	%	2.6	%	__	

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

Our cost of revenues increased from approximately ¥41.9 million in the nine months ended March 31, 2013 to approximately ¥49.0 million ($7.9 million) for the same period of 2014, an increase of approximately ¥7.0 million ($1.1 million), or 16.8%. As a percentage of revenues, our cost of revenues decreased from 67.0% in 2013 to 64.4% in 2014. This decrease was mainly caused by lower service costs.

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Gross profit. Our gross profit increased to approximately ¥27.1 million ($4.4 million) for the nine months ended March 31, 2014 from approximately ¥20.6 million for the same period in 2013. Our gross profit as a percentage of revenue increased to 35.6% for the nine months ended March 31, 2014 from 33.0% for the same period in 2013. This was mainly because fracturing services, which feature lower margins, accounted for a major part of our revenue during the nine months ended March 31, 2013. As to our automation business and furnaces business, our margins were both improved because our products and services were well received by our clients, especially our newly developed clients. .

In more detail :

	For the Nine Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues-hardware and software- non-related parties	¥35,959,339	¥73,337,585	¥37,378,246	103.9 %
Cost of revenues -hardware and software- non-related parties	23,033,622	48,447,792	25,414,170	110.3 %
Gross profit	¥12,925,717	¥24,889,793	¥11,964,076	92.6 %
Margin %	35.9 %	33.9 %	(2.0)%	__

Revenue from hardware and software to non-related parties increased ¥37.4 million was mainly due to the hardware revenue increase from the furnaces sales and automation products in the nine months ended March 31, 2014. The gross profit from the hardware and software sales to non-related parties increased ¥12.0 million ($2.0 million) compared to the same period of last year.

	For the Nine Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues - hardware and software - related parties	¥6,009,611	¥2,196,152	¥(3,813,459)	(63.5)%
Cost of revenues - hardware and software - related parties	3,139,082	426,139	(2,712,943)	(86.4)%
Gross profit	¥2,870,529	¥1,770,013	¥(1,100,516)	(38.3)%
Margin %	47.8 %	80.6 %	32.8 %	__

Cost of revenue from hardware and software-related parties decreased as revenue decreased. While gross margin increased was mainly because software business with higher margin accounted for a larger percentage this period.

	For the Nine Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Total revenues - service	¥20,567,637	¥477,769	¥(20,089,868)	(97.7)%
Cost of revenues -service	15,743,234	77,107	(15,666,127)	(99.5)%
Gross profit	¥4,824,403	¥400,662	¥(4,423,741)	(91.7)%
Margin %	23.5%	83.9%	60.4%	__

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The ¥20.6 million service revenue for the nine months ended March 31, 2013 was mainly due to several fracturing service contracts signed with Sinopec Zhongyuan oilfield. We generated 23.5% gross profit margin from these service contracts.

Operating Expenses

	For the Nine Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Selling and distribution expenses	4,693,193	4,701,989	8,796	0.2 %
% of revenue	7.5 %	6.2 %	(1.3)%	__
General and administrative expenses	8,452,540	10,450,904	1,998,364	23.6 %
% of revenue	13.5 %	13.7 %	0.2 %	__
Research and development expenses	6,284,834	4,074,953	(2,209,881)	(35.2)%
% of revenue	10.0 %	5.4 %	(4.6)%	__
Operating expenses	¥19,430,567	¥19,227,846	¥(202,721)	(1.0)%

Selling and distribution expenses. Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing organization, sales commissions, costs of our marketing programs including advertising and trade shows, and an allocation of our facilities and depreciation expenses. Selling expenses were flat at ¥4.7 million ($0.8 million) for nine months ended March 31, 2013 and 2014. Selling expenses were 7.5% of total revenues in the nine months ended March 31, 2013 and 6.2% of total revenues in the same period of 2014.

General and administrative expenses. General and administrative expenses consist primarily of costs in human resources, facilities costs, depreciation expenses, professional advisor fees, audit fees, option expenses and other expenses incurred in connection with general operations. General and administrative expenses increased by 23.6%, or ¥2.0 million ($0.3 million), from approximately ¥8.5 million in the nine months ended March 31, 2013 to approximately ¥10.5 million ($1.7 million) in the same period of 2014. General and administrative expenses were 13.5% of total revenues in 2013 and 13.7% of total revenues in 2014. The increase in general and administrative expenses was mainly due to an increase in consulting fees related to IR services, salary, an increase in the allowance for doubtful accounts, share-based compensation and traveling expenses.

Research and development ("R&D") expenses. Research and development expenses consist primarily of salaries and related expenditures of our research and development projects. Research and development expenses decreased by 35.2%, from approximately ¥6.3 million for the nine months ended March 31, 2013 to approximately ¥4.1 million ($0.7 million) for the same period of 2014. This decrease was primarily due to the lower investment of R&D materials and equipment into our furnaces and fracturing services in 2014.

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Net Income

	For the Nine Months Ended March 31,			
	2013	2014	Increase / (Decrease)	Percentage Change
Income from operations	¥1,190,082	¥7,832,622	¥6,642,540	558.2 %
Interest and other income (expense)	1,412,891	(1,246,737)	(2,659,628)	(188.2)%
Income before income taxes	2,602,973	6,585,885	3,982,912	153.0 %
Provision for income taxes	302,550	1,609,976	1,307,426	432.1 %
Net income	2,300,423	4,975,909	2,675,486	116.3 %
Less: Net income attributable to non-controlling interest	602,961	1,045,396	442,435	73.4 %
Net income attributable to ordinary shareholders	¥1,697,462	¥3,930,513	¥2,233,051	131.6 %

Income from operations. Income from operations was approximately ¥7.8 million ($1.3 million) for the nine months ended March 31, 2014, compared to income of ¥1.2 million for the same period of 2013. This increase in income from operations can be attributed primarily to the increased revenue, gross margins and decreases in research and development expenses.

Investment loss. Investment loss was ¥0.9 million ($0.1 million) for the nine months ended March 31, 2014. The Company held approximately 24.4% interest of Avalon at March 31, 2014. Since Avalon’s operating results for three months ended March 31, 2014 is not available as of the filing date, the Company used Avalon’s last quarter’s operating results as the best estimate for this period.

Interest and other income (expense). Interest and other expense was approximately ¥1.2 million ($0.2 million) for the nine months ended March 31, 2014, compared to interest and other income of ¥1.4 million for the same period of 2013. The ¥2.6 million ($0.4 million) decrease in interest and other income was primarily due to change in fair value of warrant liability , increase in loss from investment and decrease in interest income and foreign currency exchange gain, increase in loss from investment and offset by increase in subsidy income and decrease in interest expense.

Provision for income tax. Provision for income tax for the nine months ended March 31, 2013 was approximately ¥0.3 million and ¥1.6 million ($0.3 million) for the nine months ended March 31, 2014. This increase of provision for income tax was mainly due to the income from operations for the nine months ended March 31, 2014.

Net income. As a result of the factors described above, net income was approximately ¥5.0 million ($0.8 million) for the nine months ended March 31, 2014, an increase of approximately ¥2.7 million ($0.4 million) from net income of ¥2.3 million for the same period of 2013.

Net income attributable to ordinary shareholders. As a result of the factors described above, net income attributable to ordinary shareholders was approximately ¥3.9 million ($0.6 million) for the nine months ended March 31, 2014, an increase of approximately ¥2.2 million ($0.4 million) from net income attributable to ordinary shareholders of ¥1.7 million for same period of 2013.

Adjusted EBITDA

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

	For the Nine Months Ended March 31,				
	2013 RMB	2014 RMB	2014 USD	Increase / (Decrease)	Percentage Change
Reconciliation of Adjusted EBITDA to Net Income					
Net income	¥2,300,423	¥4,975,909	$807,529	¥2,675,486	116.3 %
Provision for income taxes	302,550	1,609,976	261,279	1,307,426	432.1 %
Interest expense and foreign currency adjustment	1,155,011	845,306	137,183	(309,705)	(26.8)%
Change in fair value of warrants liability	-	904,327	146,761	904,327	100 %
Loss from investment	-	870,627	141,292	870,627	100 %
Restricted shares issued for consulting services	-	407,972	66,209	407,972	100 %
Stock compensation expense	1,358,726	1,660,144	269,421	301,418	22.2 %
Depreciation and amortization	467,914	457,439	74,237	(10,475)	(2.2)%
Adjusted EBITDA	¥5,584,624	¥11,731,700	$1,903,911	¥6,147,076	110.1 %

Adjusted EBITDA improved by approximately ¥6.1 million ($1.0 million) to approximately ¥11.7 million ($1.9 million) for the nine months ended March 31, 2014 compared to approximately ¥5.6 million income for the same period in 2013. This was due to improved operations.

Adjusted Net Income (Loss) and Adjusted Earnings (Loss) Per Share

	For the Nine Months Ended		
	2013	2014	2014
	RMB	RMB	USD
Reconciliation of Net Income attributable to ordinary shareholders to Adjusted Net Income attributable to ordinary shareholders			
Net income attributable to ordinary shareholders	¥1,697,462	¥3,930,513	$637,874
Special items [(A)]:			
Change in fair value of warrants liability	-	904,327	146,761
Loss from investment	-	870,627	141,292
Restricted shares issued for consulting services	-	407,972	66,209
Stock compensation expense	1,358,726	1,660,144	269,421
Adjusted net income attributable to ordinary shareholders	¥3,056,188	¥7,773,583	$1,261,557
Reconciliation of U.S. GAAP Earnings Per Share to Non U.S. GAAP Adjusted Earnings Per Share			
U.S. GAAP earnings per share	¥0.43	¥0.92	$0.15
Impact of special items on earnings per share	0.34	0.90	0.15
Non U.S. GAAP adjusted earnings per share	¥0.77	¥1.82	$0.30
Weighted - average shares -diluted	3,951,811	4,269,510	4,269,510

(A) Special items are certain non-cash expenses that are included in our U.S. GAAP reported results. There was no income tax benefit associated with the special items. The non-GAAP financial measures are provided to enhance investors' overall understanding of Recon's current financial performance.

Liquidity and Capital Resources

Cash and Cash Equivalents. Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than six months. As of March 31 2014, we had cash and cash equivalents in the amount of approximately ¥8.9 million ($1.4 million).

Indebtedness. As of March 31, 2014, except for approximately ¥0.2 million ($32,000) of short-term borrowings from related parties, and ¥15.63 million ($2.5 million) in commercial loans from local banks, we did not have any finance leases or purchase commitments, guarantees or other material contingent liabilities.

Holding Company Structure. We are a holding company with no operations of our own. All of our operations are conducted through our Domestic Companies. As a result, our ability to pay dividends and to finance any debt that we may incur is dependent upon the receipt of dividends and other distributions from the Domestic Companies. In addition, Chinese legal restrictions permit payment of dividends to us by our Domestic Companies only out of their respective accumulated net profits, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, our Domestic Companies are required to set aside a portion (at least 10%) of their after-tax net income (after discharging all cumulated loss), if any, each year for compulsory statutory reserve until the amount of the reserve reaches 50% of our Domestic Companies' registered capital. These funds may be distributed to shareholders at the time of each Domestic Company's wind up.

Off-Balance Sheet Arrangements. We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. In addition, we have not entered into any derivative contracts that are indexed to our own shares and classified as shareholders' equity, or that are not reflected in our financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. Moreover, we do not have any variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

Capital Resources. To date we have financed our operations primarily through cash flows from operations, bank loans, short-term borrowings and stock offerings. As of March 31, 2014, we had total assets of approximately ¥156.6 million ($25.4 million), which includes cash of approximately ¥8.9 million ($1.4 million), net accounts receivable from third parties of approximately ¥55.8 million ($9.1 million), and net accounts receivable from related parties of approximately ¥16.8 million ($2.7 million). Working capital amounted to approximately ¥94.9 million ($15.4 million), and shareholders' equity amounted to approximately ¥102.9 million ($16.7 million).

Cash from Operating Activities. Net cash used in operating activities was approximately ¥15.3 million ($2.5 million) for the nine months ended March 31, 2014. This was a decrease of approximately ¥32.6 million ($5.3 million) compared to net cash provided by operating activities of approximately ¥17.3 million for the nine months ended March 31, 2013. In more detail:

Net cash used in operating activities totaled approximately ¥15.3 million for the nine months ended March 31, 2014, are primarily attributable to net income adjusted to reconcile to net cash provided by operating activities of ¥5.0 million, which primarily included an adjustment for a $0.9 million change in fair value of warrant liability , a ¥0.5 million of depreciation, a ¥0.7 million of provision for doubtful accounts, a ¥1.7 million of share based compensation, a ¥0.4 million of restricted shares issued to consulting firm and a ¥0.9 million of loss from investment. Net cash used in changes in operating assets and liabilities resulted in a net cash use of ¥25.2 million, which mainly due to a ¥12.3 million change in accounts receivable, notes receivable and other receivable, a ¥8.8 million change in inventory, a ¥5.3 million change in purchase advance, a ¥1.0 million change in other payable, a ¥1.6 million change in accrued payroll and employees' welfare, offset by a ¥2.2 million change in accounts payable, a ¥1.2 million change in taxes payable and a ¥0.9 million change in deferred income. Our net cash used in operating activities were primarily for purchase of inventories for projects in the upcoming quarters. In addition, accounts receivable increased due to our operating seasonality. Most of our projects were finished by end of calendar year, and we believe these receivables will be recovered based on contractual payment schedules.

Cash from Investing Activities. Net cash used in investing activities was approximately ¥0.2 million ($26,000) for the nine months ended March 31, 2014, a decrease of ¥0.3 million ($58,000) from ¥0.5 million for the same period of 2013. The decrease was due to a decrease in the purchase of property and equipment.

Cash from Financing Activities. Net cash provided by financing activities amounted to approximately ¥11.9 million ($1.9 million) for the nine months ended March 31, 2014, compared to cash flows used in financing activities of approximately ¥14.1 million for the same period in 2013. During the nine-month period ended March 31, 2014, we received net proceeds of ¥12.1 million ($2.0 million) from a common stock sale of 546,500 shares with institutional investors in November 2013. In addition, we repaid ¥12.87 million ($2.1 million) in short term borrowings to related parties and received ¥18.5 million ($3.0 million) of net loan proceeds from a commercial bank, which was guaranteed by one of our shareholders.

Working Capital. Total working capital as of March 31, 2014 amounted to approximately ¥94.9 million ($15.4 million), compared to approximately ¥82 million as of June 30, 2013. Total current assets as of March 31, 2014 amounted to approximately ¥148.6 million ($24.1 million), an increase of approximately ¥19.9 million ($3.2 million) compared to approximately ¥128.7 million at June 30, 2013. The increase in total current assets at March 31, 2014 compared to June 30, 2013 was mainly due to an increase in trade accounts receivable, inventory and purchase advances.

Current liabilities amounted to approximately ¥53.7 million ($8.7 million) at March 31, 2014, in comparison to approximately ¥46.7 million at June 30, 2013. This increase of liabilities was attributable mainly to an increase in short-term bank loans, trade accounts payable, taxes payable and warrant liability.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

As of March 31, 2014, the company carried out an evaluation, under the supervision of and with the participation of management, including our Company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of our Company's disclosure controls and procedures. Based on the foregoing, the chief executive officer and chief financial officer concluded that our Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were ineffective in timely alerting them to information required to be included in the Company's periodic Securities and Exchange Commission filings.

Changes in Internal Control over Financial Reporting

The Company, with the assistance of an independent internal controls consultant, has developed a specific plan to address our control deficiencies. As of March 31, 2014, the Company has completed the necessary documentation of our internal controls and implemented the following remedial initiatives:

- Improved the design and documentation related to multiple levels of review over financial statements included in our SEC filings;
- Expanded the design and assessment test work over the monitoring function of entity level controls;
- Enhanced documentation retention policies over test work related to continuous management assessments of internal control effectiveness;

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- Expanded documentation practices and policies related to various key controls to provide support and audit trails for both internal management assessment as well as external auditor testing; and
- Enhanced internal control policy implementation by hiring experienced reporting consultant and strengthening training of our financial staffs in US GAAP reporting.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) during the three months ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting, except as disclosed above.

Part II Other Information

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

Not applicable.

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

(a) None

(b) None

(c) None

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following exhibits are filed herewith:

Exhibit Number	Document
3.1	Amended and Restated Articles of Association of the Registrant (1)
3.2	Amended and Restated Memorandum of Association of the Registrant (1)
4.1	Specimen Share Certificate (1)
4.2	Form of Warrant (2)
10.1	Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.2	Translation of Power of Attorney for rights of Chen Guangqiang in Beijing BHD Petroleum Technology Co., Ltd. (1)
10.3	Translation of Power of Attorney for rights of Yin Shenping in Beijing BHD Petroleum Technology Co., Ltd. (1)
10.4	Translation of Power of Attorney for rights of Li Hongqi in Beijing BHD Petroleum Technology Co., Ltd. (1)
10.5	Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.6	Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.7	Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Li Hongqi and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.8	Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.9	Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.10	Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Li Hongqi and Beijing BHD Petroleum Technology Co., Ltd. (1)
10.11	Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Jining ENI Energy Technology Co., Ltd. (1)

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10.12 Translation of Exclusive Technical Consulting Service Agreement between Recon Technology (Jining) Co., Ltd. and Nanjing Recon Technology Co., Ltd. (1)

10.13 Translation of Power of Attorney for rights of Chen Guangqiang in Nanjing Recon Technology Co., Ltd. (1)

10.14 Translation of Power of Attorney for rights of Yin Shenping in Nanjing Recon Technology Co., Ltd. (1)

10.15 Translation of Power of Attorney for rights of Li Hongqi in Nanjing Recon Technology Co., Ltd. (1)

10.16 Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Chen Guangqiang and Nanjing Recon Technology Co., Ltd. (1)

10.17 Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Yin Shenping and Nanjing Recon Technology Co., Ltd. (1)

10.18 Translation of Exclusive Equity Interest Purchase Agreement between Recon Technology (Jining) Co. Ltd., Li Hongqi and Nanjing Recon Technology Co., Ltd. (1)

10.19 Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Chen Guangqiang and Nanjing Recon Technology Co., Ltd. (1)

10.20 Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Yin Shenping and Nanjing Recon Technology Co., Ltd. (1)

10.21 Translation of Equity Interest Pledge Agreement between Recon Technology (Jining) Co., Ltd., Li Hongqi and Nanjing Recon Technology Co., Ltd. (1)

10.22 Employment Agreement between Recon Technology (Jining) Co., Ltd. and Mr. Yin Shenping (1)

10.23 Employment Agreement between Recon Technology (Jining) Co., Ltd. and Mr. Chen Guangqiang (1)

10.24 Employment Agreement between Recon Technology (Jining) Co., Ltd. and Mr. Li Hongqi (1)

10.25 Operating Agreement among Recon Technology (Jining) Co. Ltd., Nanjing Recon Technology Co., Ltd. and Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi (1)

10.26 Operating Agreement among Recon Technology (Jining) Co. Ltd., Beijing BHD and Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi (1)

21.1 Subsidiaries of the Registrant (3)

31.1 Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (4)

31.2 Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (4)

32.1	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (4)
32.1	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (4)
99.1	Stock Option Plan (1)
99.2	Code of Business Conduct and Ethics (1)
99.3	Press Release dated May 15, 2014 (4)

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101.INS	XBRL Instance Document [5]
101.SCH	XBRL Taxonomy Extension Schema Document [5]
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document [5]
101.LAB	XBRL Taxonomy Extension Label Linkbase Document [5]
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document [5]
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document [5]

(1) Incorporated by reference to the Company's Registration Statement on Form S-1, Registration No. 333-152964.
(2) Incorporated by reference to the Company's Report on Form 8-K, filed on November 25, 2013.
(3) Incorporated by reference to the Company's Quarterly Report on Form 10-Q/A, filed on January 31, 2012.
(4) Filed herewith.
(5) Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

SIGNATURES

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

	RECON TECHNOLOGY, LTD	
May 15, 2014	By:	/s/ Liu Jia
		Liu Jia
		Chief Financial Officer
		(Principal Financial and Accounting Officer)

SIGNATURES

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

	RECON TECHNOLOGY, LTD	
May 15, 2014	By:	/s/ Yin Shen Ping
		Yin Shen Ping
		Chief Executive Officer

RECON TECHNOLOGY, LTD

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RECON TECHNOLOGY, LTD

UNaudited condensed Consolidated Balance Sheets

	As of June 30, 2013 RMB	As of March 31, 2014 RMB	As of March 31, 2014 U.S. Dollars
ASSETS			
Current assets			
Cash and cash equivalents	¥ 12,350,392	¥ 8,863,889	$ 1,438,499
Notes receivable	2,578,855	-	-
Trade accounts receivable, net	38,648,780	55,808,726	9,057,065
Trade accounts receivable- related parties, net	18,744,364	16,794,476	2,725,535
Inventories, net	13,271,070	22,094,753	3,585,705
Other receivables, net	19,131,503	15,970,126	2,591,754
Other receivables- related parties	742,528	664,831	107,894
Purchase advances, net	18,412,507	23,480,982	3,810,672
Purchase advances- related parties	394,034	394,034	63,947
Tax recoverable	575,650	-	-
Prepaid expenses	2,853,956	3,434,100	557,311
Deferred tax asset	1,006,721	1,082,436	175,666
Total current assets	128,710,360	148,588,353	24,114,048
Property and equipment, net	1,709,846	1,345,742	218,397
Long-term investment	1,549,450	674,792	109,510
Long-term other receivable	3,502,680	5,993,198	972,622
Total Assets	¥ 135,472,336	¥ 156,602,085	$ 25,414,577
LIABILITIES AND EQUITY			
Current liabilities			
Short-term bank loans	¥ 10,000,000	¥ 15,630,000	$ 2,536,555
Trade accounts payable	7,384,165	13,595,942	2,206,453
Trade accounts payable- related parties	3,994,718	-	-
Other payables	1,964,691	1,773,163	287,762
Other payable- related parties	4,239,675	3,382,337	548,911
Deferred revenue	3,381,382	4,326,473	702,133
Advances from customers	470,700	275,600	44,726
Accrued payroll and employees' welfare	1,992,783	389,443	63,202
Accrued expenses	488,730	246,113	39,942
Taxes payable	6,754,428	7,909,731	1,283,651
Short-term borrowings- related parties	5,503,279	200,000	32,458
Short-term borrowings- other	570,375	-	-
Warrants liability	-	5,992,127	972,448
Total current liabilities	46,744,926	53,720,929	8,718,241
Commitments and Contingency			

Equity			
Common stock, ($ 0.0185 U.S. dollar par value, 25,000,000 shares authorized; 3,951,811 and 4,528,311 shares issued and outstanding as of June 30, 2013 and March 31, 2014, respectively)	529,979	595,335	96,613
Additional paid-in capital	69,516,447	78,669,718	12,767,120
Appropriated retained earnings	3,023,231	4,868,048	790,024
Unappropriated retained earnings	8,749,963	10,835,662	1,758,494
Accumulated other comprehensive loss	(293,201)	(326,126)	(52,925)
Total controlling shareholders’ equity	81,526,419	94,642,637	15,359,326
Non-controlling interest	7,200,991	8,238,519	1,337,010
Total equity	88,727,410	102,881,156	16,696,336
Total Liabilities and Equity	¥ 135,472,336	¥ 156,602,085	$ 25,414,577

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

RECON TECHNOLOGY, LTD

UNaudited condensed Consolidated Statements of OPERATIONS and Comprehensive Income (LOSS)

	For the nine months ended March 31,			For the three months ended March 31,		
	2013 RMB	2014 RMB	2014 USD	2013 RMB	2014 RMB	2014 USD
Revenues						
Hardware and software	¥35,959,339	¥73,337,585	$11,901,781	¥4,161,583	¥17,998,444	$2,920,924
Service	20,567,637	477,769	77,536	62,678	80,180	13,012
Hardware and software - related parties	6,009,611	2,196,152	356,408	3,277,534	153,846	24,967
Total revenues	62,536,587	76,011,506	12,335,725	7,501,795	18,232,470	2,958,903
Hardware and software	23,033,622	48,447,792	7,862,476	2,527,534	12,848,136	2,085,093
Service	15,743,234	77,107	12,514	20,620	42,161	6,842
Hardware and software - related parties	3,139,082	426,139	69,157	798,190	97,217	15,777
Total cost of revenues	41,915,938	48,951,038	7,944,147	3,346,344	12,987,514	2,107,712
Gross profit	20,620,649	27,060,468	4,391,578	4,155,451	5,244,956	851,191
Selling and distribution expenses	4,693,193	4,701,989	763,075	1,790,199	1,097,549	178,119
General and administrative expenses	8,452,540	10,450,904	1,696,052	3,966,782	3,993,341	648,070
Research and development expenses	6,284,834	4,074,953	661,314	552,645	720,956	117,002
Operating expenses	19,430,567	19,227,846	3,120,441	6,309,626	5,811,846	943,191
Income (loss) from operations	1,190,082	7,832,622	1,271,137	(2,154,175)	(566,890)	(92,000)
Other income (expenses)						
Subsidy income	2,143,669	1,220,024	197,995	1,343,669	201,711	32,735
Interest income	443,391	296,997	48,199	137,803	92,027	14,935
Interest expense	(1,494,887)	(757,226)	(122,888)	(618,473)	(277,578)	(45,047)
Loss from investment	-	(870,627)	(141,292)	-	(135,547)	(21,998)
Change in fair value of warrants liability	-	(904,327)	(146,761)	-	(904,883)	(146,851)
Gain (loss) from foreign currency exchange	339,876	(88,080)	(14,294)	(185)	31,312	5,082
Other income (expense)	(19,158)	(143,498)	(23,288)	(109,881)	(99,552)	(16,156)

Income (loss) before income tax	2,602,973	6,585,885	1,068,808	(1,401,242)	(1,659,400)	(269,300)
Provision for income tax	302,550	1,609,976	261,279	(152,382)	150,787	24,471
Net Income (loss)	2,300,423	4,975,909	807,529	(1,248,860)	(1,810,187)	(293,771)
Less: Net income attributable to non-controlling interest	602,961	1,045,396	169,655	(2,127)	120,415	19,542
Net Income attributable to Recon Technology, Ltd	¥1,697,462	¥3,930,513	$637,874	¥(1,246,733)	¥(1,930,602)	$(313,313)
Comprehensive income (loss)						
Net income	¥2,300,423	¥4,975,909	$807,529	¥(1,248,860)	¥(1,810,187)	$(293,771)
Foreign currency translation adjustment	(16,889)	(40,833)	(6,627)	(717)	(118,110)	(19,168)
Comprehensive income (loss)	2,283,534	4,935,076	800,902	(1,249,577)	(1,928,297)	(312,939)
Less: Comprehensive income attributable to non-controlling interest	601,084	1,041,313	168,992	(2,207)	108,604	17,625
Comprehensive income (loss) attributable to Recon Technology, Ltd	¥1,682,450	¥3,893,763	$631,910	¥(1,247,370)	¥(2,036,901)	$(330,564)
Earnings (loss) per common share - basic	¥0.43	¥0.93	$0.15	¥(0.32)	¥(0.43)	$(0.07)
Earnings (loss) per common share - diluted	¥0.43	¥0.92	$0.15	¥(0.32)	¥(0.43)	$(0.07)
Weighted - average shares -basic	3,951,811	4,211,785	4,211,785	3,951,811	4,528,311	4,528,311
Weighted - average shares -diluted	3,951,811	4,269,510	4,269,510	3,951,811	4,528,311	4,528,311

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

RECON TECHNOLOGY, LTD

unaudited condensed Consolidated Statements of Cash Flows

	For the nine months ended March 31,		
	2013	2014	2014
	RMB	RMB	U.S. Dollars
Cash flows from operating activities:			
Net income	¥2,300,423	¥4,975,909	$807,529
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	467,914	457,439	74,237
Loss from disposal of equipment	26,845	67,587	10,969
Provision/(recovery of) for doubtful accounts	(82,420)	668,610	108,507
Share based compensation	1,358,726	1,660,144	269,421
Loss from investment	-	870,627	141,292
Deferred tax provision/(benefit)	12,363	(75,715)	(12,288)
Change in fair value of warrants liability	-	904,327	146,761
Restricted shares issued to consulting firm	-	407,972	66,209
Changes in operating assets and liabilities:			
Trade accounts receivable	13,156,606	(17,127,239)	(2,779,539)
Trade accounts receivable-related parties	2,701,259	1,487,501	241,403
Notes receivable	-	2,578,855	418,516
Inventories	9,397,201	(8,823,683)	(1,431,974)
Other receivable, net	(4,641,896)	688,724	111,770
Other receivables related parties, net	(1,038,967)	77,697	12,609
Purchase advance, net	(5,597,453)	(5,325,269)	(864,225)
Purchase advance-related party, net	(300,500)	-	-
Tax recoverable	2,790,722	575,650	93,421
Prepaid expense	(274,350)	(580,144)	(94,150)
Trade accounts payable	(5,643,032)	6,211,777	1,008,094
Trade accounts payable-related parties	110,157	(3,994,718)	(648,293)
Other payables	(51,139)	(191,528)	(31,083)
Other payables-related parties	4,899,620	(857,338)	(139,135)
Deferred income	(155,169)	945,091	153,377
Advances from customers	244,996	(195,100)	(31,662)
Accrued payroll and employees' welfare	713,859	(1,603,340)	(260,202)
Accrued expenses	(133,253)	(242,617)	(39,374)
Taxes payable	(2,988,030)	1,155,303	187,491
Net cash provided by (used in) operating activities	17,274,482	(15,283,478)	(2,480,319)
Cash flows from investing activities:			
Purchase of property and equipment	(676,504)	(258,922)	(42,020)
Proceeds from disposal of equipment	161,000	98,000	15,904
Net cash used in investing activities	(515,504)	(160,922)	(26,116)

Cash flows from financing activities:			
Proceeds from short-term bank loans	8,350,000	18,500,000	3,002,321
Repayments of short-term bank loans	(21,652,952)	(12,870,000)	(2,088,641)
Proceeds from borrowings-related parties	3,658,102	-	-
Repayment of short-term borrowings	(2,275,764)	(570,375)	(92,565)
Repayment of short-term borrowings-related parties	(2,232,477)	(5,303,279)	(860,656)
Proceeds from sale of common stock, net of issuance costs	-	12,132,882	1,969,016
Capital contribution in VIE	20,000	-	-
Net cash provided by (used in) financing activities	(14,133,091)	11,889,228	1,929,475
Effect of exchange rate fluctuation on cash and cash equivalents	293,521	68,669	11,143
Net increase (decrease) in cash and cash equivalents	2,919,408	(3,486,503)	(565,817)
Cash and cash equivalents at beginning of period	3,533,283	12,350,392	2,004,316
Cash and cash equivalents at end of period	¥6,452,691	¥8,863,889	$1,438,499
Supplemental cash flow information			
Cash paid during the period for interest	¥1,356,581	¥952,125	$154,518
Cash paid during the period for taxes	¥832,028	¥700,268	$113,645

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

RECON TECHNOLOGY, LTD

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND NATURE OF OPERATIONS

Organization – Recon Technology, Ltd (the “Company”) was incorporated under the laws of the Cayman Islands on August 21, 2007 as a company with limited liability. The Company provides oilfield specialized equipment, automation systems, tools, chemicals and field services to petroleum companies in the People’s Republic of China (the “PRC”). Its wholly owned subsidiary, Recon Technology Co., Limited (“Recon-HK”) was incorporated on September 6, 2007 in Hong Kong. Other than the equity interest in Recon-HK, the Company does not own any assets or conduct any operations. On November 15, 2007, Recon-HK established one wholly owned subsidiary, Jining Recon Technology Ltd. (“Recon-JN”) under the laws of the PRC. Other than the equity interest in Recon-JN, Recon-HK does not own any assets or conduct any operations.

The Company conducts its business through the following PRC legal entities that were consolidated as variable interest entities (“VIEs”) and operate in the Chinese oilfield equipment & service industry:

1. Beijing BHD Petroleum Technology Co., Ltd. (“BHD”), and

2. Nanjing Recon Technology Co., Ltd. (“Nanjing Recon”).

Nature of Operations – The Company engaged in (1) providing equipment, tools and other hardware related to oilfield production and management, including simple installations in connection with some projects; (2) service to improve production and efficiency of exploited oil wells, and (3) developing and selling its own specialized industrial automation control and information solutions. The products and services provided by the Company include:

High-Efficiency Heating Furnaces - High-Efficiency Heating Furnaces are designed to remove the impurities and to prevent solidification blockage in transport pipes carrying crude petroleum. Crude petroleum contains certain impurities including water and natural gas, which must be removed before the petroleum can be sold.

Multi-Purpose Fissure Shaper - Multipurpose fissure shapers improve the extractors’ ability to test for and extract petroleum which requires perforation into the earth before any petroleum extractor can test for the presence of oil.

Horizontal Multistage Fracturing related Service - The Company mainly uses Baker Hughes FracPoint™ system and provides related service to oilfield companies. The Baker Hughes FracPoint™ system provided a completion method using packers to isolate sections of the wellbore (stages) and frac sleeves to direct the frac treatment to the desired stage. The use of this type of completion eliminated the need for cementing the liner, coiled tubing operations, and wireline operations, while significantly reducing overall pumping time.

Supervisory Control and Data Acquisition System ("SCADA") - SCADA is an industrial computerized process control system for monitoring, managing and controlling petroleum extraction. SCADA integrates underground and aboveground activities of the petroleum extraction industry. This system can help to manage the oil extraction process in real-time to reduce the costs associated with extraction.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The accompanying unaudited condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The accompanying unaudited condensed consolidated financial statements include the accounts of the Company, its subsidiaries, and VIEs for which the Company is the primary beneficiary. All inter-company transactions and balances between the Company, its subsidiaries and VIEs are eliminated upon consolidation. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring entries, which are necessary for a fair presentation of the results for the interim periods presented. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended June 30, 2013. The results of operations for the interim periods presented may not be indicative of the operating results to be expected for the Company's fiscal year ending June 30, 2014.

RECON TECHNOLOGY, LTD

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

***Variable Interest Entities* -** A VIE is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. A VIE is consolidated by its primary beneficiary. The primary beneficiary has both the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. We perform ongoing assessments to determine whether an entity should be considered a VIE and whether an entity previous identified as a VIE continues to be a VIE and whether we continue to be the primary beneficiary.

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

Currency Translation - The Company's functional currency is the Chinese Yuan ("RMB") and the accompanying consolidated financial statements have been expressed in Chinese Yuan. The statements as of and for the three and nine months period ended March 31, 2014 have been translated into United States dollars ("U.S. dollars") solely for the convenience of the readers. The translation has been made at the rate of ¥6.1619 = US$1.00, the approximate exchange rate prevailing on March 31, 2014. These translated U.S. dollar amounts should not be construed as representing Chinese Yuan amounts or that the Chinese Yuan amounts have been or could be converted into U.S. dollars.

Estimates and assumptions- The preparation of the consolidated financial statements in conformity with U.S. GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are adjusted to reflect actual experience when necessary. Significant estimates include revenue recognition, allowance for doubtful accounts, the useful lives of property and equipment and the fair value of stock based payments. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates.

Fair Values of Financial Instruments - The US GAAP accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The three levels of inputs are defined as follows:

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

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

Level 3 inputs to the valuation methodology are unobservable.

The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, purchase advances, trade accounts payable, accrued liabilities, advances from customers, short-term bank loan and short-term borrowings approximate fair value because of the immediate or short-term maturity of these financial instruments. Long-term borrowings approximate fair value because the interest rate charged approximates the market rate. Long-term other receivables approximate fair value because interest rate approximates the market rate. Long-term investment is carried at less than fair value, with fair value determined using level 1 inputs. (See Note 8.)

The fair value of the warrants liability was determined using the Black-Scholes Model, as Level 2 inputs (See Note 13).

Cash and Cash Equivalents - Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated original maturities of no more than three months. Since a majority of the bank accounts are located in the PRC, those bank balances are uninsured.

RECON TECHNOLOGY, LTD

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Trade Accounts and Other Receivables - Accounts receivable are carried at original invoiced amount less a provision for any potential uncollectible amounts. Accounts are considered past due when the related receivables are more than a year old. Provision is made against trade accounts and other receivables to the extent they are considered to be doubtful. Accounts are written off after extensive efforts at collection. Other receivables arise from transactions with non-trade customers.

Purchase Advances - Purchase advances are the amounts prepaid to suppliers for purchases of inventory and are recognized as inventory when the final amount is paid to the suppliers and the inventory is delivered.

Inventories - Inventories are stated at the lower of cost or market value, on a weighted average basis for BHD. Inventories are stated at the lower of cost or market value, on a first-in-first-out basis for Nanjing Recon and ENI. The methods of determining inventory costs are used consistently from year to year. Allowance for inventory obsolescence is provided when the market value of certain inventory items are lower than the cost.

Tax Recoverable – Tax recoverable represented amounts paid for value added tax (“VAT”) on purchases in the PRC amounting to ¥575,650 at June 30, 2013. The amount can be used to offset VAT payable on sales made by the Company.

Property and Equipment - Property and equipment are stated at cost. Depreciation on motor vehicles and office equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from two to ten years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the assets.

Long-term investment – Long-term investment in equity over which the Company has the ability to exercise significant influence but not control, and that, in general, are 20-50 percent owned, are stated at cost plus equity in undistributed net income (loss) of the investee. These investments are evaluated for impairment, in which an impairment loss would be recorded whenever a decline in the value of an equity investment below its carrying amount is determined to be “other than temporary.” In judging “other than temporary,” the Company would consider the length of time and extent to which the fair value of the investment has been less than the carrying amount of the investment, the near-term and longer-term operating and financial prospects of the investee, and the Company’s longer-term intent of retaining the investment in the investee.

Long-Lived Assets - The Company applies the ASC Topic 360 “Property, plant and equipment.” ASC Topic 360 requires that long-lived assets, such as property and equipment be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. Fair value is determined based on the estimated discounted future cash flows expected to be generated by the asset. There were no impairments at June 30, 2013 and March 31, 2014.

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

Hardware:

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

RECON TECHNOLOGY, LTD

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Software:

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

Service:

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

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

Subsidy Income - Grants are given 1) by the government to support local software companies' operation and research and development and 2) by some local government to support development of selected middle and small-sized enterprises. Grants related to research and development projects are recognized as subsidy income in the unaudited condensed consolidated statements of operations when received. Grants in the form of value-added-tax refund for software products are recognized when received.

Share-Based Compensation - The Company accounts for share-based compensation in accordance with ASC Topic 718, *Share-Based Payment*. Under the fair value recognition provisions of this topic, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense with graded vesting on a straight–line basis over the requisite service period for the entire award. The Company has elected to recognize compensation expenses mainly using the Black-Scholes valuation model estimated at the grant date based on the award's fair value.

Income Taxes - Income taxes are provided based upon the liability method of accounting pursuant to ASC Topic 740, *Accounting for Income Taxes*. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes. Deferred taxes are provided on differences between the tax bases of assets and liabilities and their reported amounts in the financial statements, and tax carry forwards. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company has not been subject to any income taxes in the United States or the Cayman Islands.

Under ASC Topic 740, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position would be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. Income tax returns for the years prior to 2009 are no longer subject to examination by tax authorities.

Earnings (loss) per Share ("EPS") - Basic EPS is computed by dividing net income (loss) attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding. Diluted EPS are computed by dividing net income (loss) attributable to ordinary shareholders by the weighted-average number of ordinary shares and dilutive potential ordinary share equivalents outstanding.

Basic net income per share is computed by dividing net income available to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted income per share is computed by dividing net income by the weighted average number of shares of ordinary shares, ordinary shares equivalents and potentially dilutive securities outstanding during each period. Potentially dilutive ordinary shares consist of ordinary shares issuable upon the conversion of ordinary stock options, restricted shares and warrants (using the treasury stock method). For the nine months ended March 31, 2014, there were 57,725 restricted shares included in the weighted average dilutive shares calculation. However, the effect from options, restricted shares and warrants would have been anti-dilutive due to the fact that we incurred a net loss during the three months ended March 31, 2013 and 2014.

Reclassification – The Company made some reclassification of revenue from software - related parties for the three months ended March 31, 2013.

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. TRADE ACCOUNTS RECEIVABLE, NET

Accounts receivable consisted of the following:

Third Party	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Trade accounts receivable	¥42,993,298	¥ 60,120,536	$ 9,756,818
Allowance for doubtful accounts	(4,344,518)	(4,311,810)	(699,753)
Total - third-party, net	¥38,648,780	¥ 55,808,726	$ 9,057,065

Related Party	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Beijing Yabei Nuoda Science and Technology Co. Ltd.	¥19,722,574	¥ 18,235,072	$ 2,959,326
Allowance for doubtful accounts	(978,210)	(1,440,596)	(233,791)
Total - related-parties, net	¥18,744,364	¥ 16,794,476	$ 2,725,535

One of the Founders, Mr. Yin Shenping, is the legal representative of Beijing Yabei Nuoda Science and Technology Co. Ltd ("Yabei Nuoda"). The founder does not have any equity interest in this company currently. The receivable from Yabei Nuoda was generated primarily from the sale of automation system and services based on written contracts.

NOTE 4. OTHER RECEIVABLES, NET

Other receivables consisted of the following:

Third Party Current Portion	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Due from ENI (A)	¥6,799,669	¥ 2,498,526	$ 405,480
Loans to third parties (B)	8,440,639	8,118,542	1,317,539
Business advance to staff (C)	2,977,176	5,089,502	825,963
Deposits for projects	185,669	308,944	50,138
Others	1,210,230	418,626	67,938
Allowance for doubtful accounts	(481,880)	(464,014)	(75,304)
Total	¥19,131,503	¥ 15,970,126	$ 2,591,754

RECON TECHNOLOGY, LTD

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Third Party	June 30, 2013	March 31, 2014	March 31, 2014
Non-Current Portion	RMB	RMB	U.S. Dollars
Due from ENI (A)	¥3,502,680	¥5,993,198	$972,622
Total	¥3,502,680	¥5,993,198	$972,622

(A) Due from ENI represents a working capital loan to the Company's former VIE. The loan balance had been an intercompany balance and was eliminated in the Company's consolidated financial statements before the deconsolidation of ENI. It was reclassified to other receivables after ENI ceased to be a VIE of the Company on December 16, 2010. In January 2012, ENI agreed to repay the loan on a payment schedule, and interest is accruing during the period at an annual rate of 4%. In accordance with the payment schedule, the principal plus accrued interest is required to be repaid over approximately three years on a quarterly basis beginning March 2012. The first four payments were RMB 1.2 million each. In March, June, September and December of 2012, the Company received an aggregate of RMB 4.8 million. Starting March 2013, installments for each quarter would be ¥1,777,653. The Company has received the payments timely in March and June of 2013. On September 30, 2013, ENI proposed to extend the payment period and resigned an agreement with the Company. According to the new agreement, the remaining balance of this loan would be repaid over four years with installments of ¥699,147 each quarter including interest. The payments required after 1 year are RMB 5,993,198 ($972,622).

(B) Loans to third parties are mainly used for short-term funding to support cooperative companies. These loans are due on demand bearing no interest.

(C) Business advance to staff represents advances for business travel and sundry expenses related to oilfield or on-site installation and inspection of products through customer approval and acceptance.

Other receivables - related parties represent loans to related parties for working capital advances to related entities. Such advances are due-on-demand and non-interest bearing.

Below is a summary of other receivables - related parties which consisted of the following:

Related Party

Name of Related Party	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Beijing Yabei Nuoda Science and Technology Co. Ltd.	¥500,000	¥500,000	$81,144
Other-travel advances (A)	242,528	164,831	26,750
Total	¥742,528	¥664,831	$107,894

(A) Other travel advances were paid to the Company’s management.

NOTE 5. PURCHASE ADVANCES

The Company purchased products and services from a third-party and a related party during the normal course of business. Purchase advances consisted of the following:

Third Party	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Prepayment for inventory purchase	¥19,237,449	¥24,562,718	$3,986,225
Allowance for doubtful accounts	(824,942)	(1,081,736)	(175,553)
Total	¥18,412,507	¥23,480,982	$3,810,672

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Below is a summary of purchase advances to related party.

	June 30, 2013	March 31, 2014	March 31, 2014
Third Party	RMB	RMB	U.S. Dollars
Xiamen Huangsheng Hitek Computer Network Co. Ltd	¥394,034	¥394,034	$63,947
Total	¥394,034	¥394,034	$63,947

One of the Founders and a family member collectively own 57% of Xiamen Huasheng Haitian Computer Network Co. Ltd.

NOTE 6. INVENTORIES

Inventories consisted of the following:

	June 30, 2013	March 31, 2014	March 31, 2014
	RMB	RMB	U.S. Dollars
Small component parts	¥45,314	¥52,922	$8,589
Purchased goods and raw materials	-	256,411	41,612
Work in process	1,356,755	2,818,145	457,350
Finished goods	11,869,001	18,967,275	3,078,154
Total inventories	¥13,271,070	¥22,094,753	$3,585,705

There was no inventory obsolescence reserve at June 30, 2013 and March 31, 2014.

NOTE 7. PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following:

	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Motor vehicles	¥2,683,250	¥2,436,831	$395,467
Office equipment and fixtures	593,654	647,395	105,064
Total property and equipment	3,276,904	3,084,226	500,531
Less: Accumulated depreciation	(1,567,058)	(1,738,484)	(282,134)
Property and equipment, net	¥1,709,846	¥1,345,742	$218,397

Depreciation expense was ¥152,757 and ¥156,098 ($25,333) for the three months ended March 31, 2013 and 2014, respectively.

Depreciation expense was ¥467,914 and ¥457,439 ($74,237) for the nine months ended March 31, 2013 and 2014, respectively.

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. LONG-TERM INVESTMENT

On June 28, 2013, the Company purchased 2,800,000 restricted shares of Avalon Oil and Gas, Inc. ("Avalon") for $0.089 per share, or approximately ¥1.5 million ($250,000). Since the restriction for the shares is for two years, the Company was able to acquire the shares at 50% of the market value. The investment was accounted for using the equity method and no gain or loss from equity investment was recorded for the year ended June 30, 2013 due to immateriality. As of March 31, 2014, Recon owned 24.4% of Avalon's outstanding shares due to Avalon issuing more shares. Avalon is an independent US domestic oil and natural gas producer listed on the OTCBB under the ticker symbol AOGN. Avalon is building a portfolio of oil and gas producing properties to generate asset growth. Since Avalon's operating results for the year ended March 31, 2014 were not available as of the filing date, the Company recorded Avalon's operating results from October to December its investment loss for the three months ended March 31, 2014. For the three and nine months ended March 31, 2014, Avalon had revenue of approximately $35,000 and $94,000, net loss attributable to common shareholders of $0.2 million and $0.6 million, respectively. The Company recorded a loss from its equity investment of ¥135,547 ($21,998) and ¥870,627 ($141,292) for the three and nine months ended March 31, 2014, respectively.

NOTE 9. OTHER PAYABLES

Other payables consisted of the following:

Third Party	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Consulting services	¥1,199,716	¥269,673	$43,765
Due to ENI (A)	148,000	-	-
Distributors and employees	580,648	1,152,239	186,994
Others	36,327	351,251	57,003
Total	¥1,964,691	¥1,773,163	$287,762

(A) A former VIE of the Company, which ceased to be a VIE on December 16, 2010.

Related Party	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Due to related parties (1)	¥2,860,824	¥2,560,649	$415,563
Expenses paid by the major shareholders	467,499	570,595	92,600
Due to family member of one owner on behalf on Recon	716,000	-	-
Due to management staff on behalf of Recon	195,352	251,093	40,748
Total	¥4,239,675	¥3,382,337	$548,911

(1) Includes an advance from Yabei Nuoda for RMB 61,302 and an advance from Xiamen Henda Haitek for RMB 2,499,347 to supplement the Company’s working capital. The advances are payable on demand and non-interest bearing.

NOTE 10. TAXES PAYABLE

Taxes payable consisted of the following:

	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
VAT payable	¥2,802,890	¥3,066,887	$497,718
Business tax payable	75,865	75,865	12,312
Enterprise income tax payable	3,850,288	4,835,712	784,776
Other taxes payable (receivable)	25,385	(68,733)	(11,155)
Total taxes payable	¥6,754,428	¥7,909,731	$1,283,651

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RECON TECHNOLOGY, LTD

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. SHORT-TERM BANK LOANS

Short-term bank loans consisted of the following:

	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Communication Bank, 6.6% annual interest, due on November 15, 2014	¥3,090,000	¥3,090,000	¥501,469
Communication Bank, 6.6% annual interest, due on November 15, 2014	1,910,000	1,910,000	309,969
Beijing Bank, 5.75% annual interest, matures and paid off by February 25, 2014	1,200,000	-	-
Beijing Bank, 5.75 % annual interest, matures and paid off by February 27, 2014	600,000	-	-
Beijing Bank, 5.75 % annual interest, repaid on April 9, 2014	1,200,000	360,000	58,423
Beijing Bank, 5.75 % annual interest, repaid on April 16, 2014	900,000	270,000	43,818
Beijing Bank, 5.75 % annual interest, matures and paid off by March 11, 2014	1,100,000	-	-
Industrial and Commercial Bank, floating interest rate at 6.3%, due on July 28, 2014	-	3,060,000	496,600
Industrial and Commercial Bank, floating interest rate at 6.3%, due on August 8, 2014	-	1,000,000	162,288
Industrial and Commercial Bank, floating interest rate at 6.3%, due on February 17, 2015	-	3,100,000	503,092
Industrial and Commercial Bank, floating interest rate at 6.3%, due on June 13, 2014	-	2,840,000	460,896

Total short-term bank loans	¥10,000,000	¥15,630,000	$2,536,555

Interest expense was ¥437,436 and ¥277,445 ($45,026) for the three months ended March 31, 2013 and 2014, respectively.

Interest expense was ¥1,183,845 and ¥754,202 ($122,398) for the nine months ended March 31, 2013 and 2014, respectively.

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12. SHORT-TERM BORROWINGS

Short-term borrowings are generally extended upon maturity and consisted of the following:

	June 30, 2013	March 31, 2014	March 31, 2014
Short-term borrowings due to non-related parties:	RMB	RMB	U.S. Dollars
Short-term borrowing, 6% annual interest, matures and paid off by November 9, 2013	¥70,375	¥ -	$ -
Short-term borrowings with no interest, beginning April 22, 2013, paid off on January 31, 2014	500,000	-	-
Total short-term borrowings due to non-related parties	¥570,375	¥ -	$ -

Interest expense for short-term borrowings due to non-related parties was ¥16,754 and none for the three months ended March 31, 2013 and 2014, respectively.

Interest expense for short-term borrowings due to non-related parties was ¥56,890 and ¥1,525 ($247) for the nine months ended March 31, 2013 and 2014, respectively.

	June 30, 2013	March 31, 2014	March 31, 2014
Short-term borrowings due to related parties:	RMB	RMB	U.S. Dollars
Due-on-demand borrowings from Founders, no interest	¥6,377	¥-	$-
Short-term borrowing from a Founder's family member, 6% annual interest, matures and paid off by December 21, 2013	3,653,906	-	-
Short-term borrowing from a Founder's family member, 6% annual interest, matures and paid off by November 29, 2013	1,610,000	-	-
Short-term borrowings from Xiamen Huasheng Haitian Computer Network Co. Ltd., no interest, due on November 14, 2014	200,000	200,000	32,458
	32,996	-	-

Short-term borrowings from management, 6% annual interest, matures and paid off by December 7, 2013			
Total short-term borrowings due to related parties	¥5,503,279	¥200,000	$32,458

Interest expense for short-term borrowings due to related parties was ¥151,742 and none for the three months ended March 31, 2013 and 2014, respectively.

Interest expense for short-term borrowings due to related parties was ¥265,649 and ¥1,441 ($234) for the nine months ended March 31, 2013 and 2014, respectively.

Note 13 –WARRANT LIABILITY

In connection with the stock offering in November 2013, the Company issued warrants to certain institutional investors and placement agent to purchase 218,600 ordinary shares (see details in Note 14).

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RECON TECHNOLOGY, LTD

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According to ASC 815-40, if the strike price of the warrants is denominated in a currency other than the Company's functional currency, the warrants are not considered indexed to the entity's own stock. The Company's functional currency is RMB and the strike price of the warrants is denominated in USD, as a result, the warrants are classified as liabilities with all future changes in the fair value of these warrants recognized in earnings until such time as the warrants are exercised or expired.

These common stock purchase warrants do not trade in an active securities market, and as such, their fair value is estimated by using the Cox-Ross-Rubinstein (CRR) Binomial Model using the following assumptions:

	March 31, 2014		November 29, 2013	
Annual dividend yield	-		-	
Exercised price	5.38		5.38	
Underlying stock price at valuation date	4.66		3.86	
Expected life (years)	2.67		3	
Risk-free interest rate	0.90	%	0.56	%
Expected volatility	248	%	272	%

Expected volatility is based on the historical volatility of the Company's common stock. The Company has no reason to believe future volatility over the expected remaining life of these warrants is likely to differ materially from historical volatility. The expected life is based on the remaining term of the warrants. The risk-free interest rate is based on U.S. Treasury securities according to the remaining term of the warrants. The expected dividend yield was based on the Company's current and expected dividend policy.

The following table sets forth by level within the fair value hierarchy the warrants liability that was accounted at fair value on a recurring basis.

	Fair Value Measurement at March 31, 2014			Carrying Value at March 31, 2014	Carrying Value at March 31, 2014
	Level 1	Level 2	Level 3	RMB	USD
Warrants liability	¥ -	¥ 5,992,127	¥ -	¥ 5,992,127	$ 972,448

The following is a reconciliation of the beginning and ending balance of the warrant liability measured at fair value on a recurring basis for nine months ended March 31, 2014:

	Change of warrants liability	
	RMB	USD
Beginning balance - June 30, 2013	-	-
Initial measurement of warrants liability on November 29, 2013	¥5,087,800	$825,687
Change of warrant liability from November 29, 2013 to March 31, 2014	904,327	146,761
Ending balance - March 31, 2014	¥5,992,127	$972,448

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14. SHAREHOLDERS' EQUITY

Stock offering – On November 25, 2013, the Company entered into a securities purchase agreement ("Purchase Agreement") with certain institutional investors for the sale of 546,500 ordinary shares in a registered direct offering at the price of $4.81 per ordinary share (amended to $4.30 per ordinary share on November 29, 2013). The net cash proceeds received from the stock offering, after deducting underwriter commission and other associated fees, were ¥12,132,882 (approximately $2.0 million). In addition, warrants to purchase 163,950 ordinary shares in the aggregate were issued to the investors. The warrants will be exercisable immediately as of the date of issuance at an exercise price of $6.01 per ordinary share (amended to $5.38 per ordinary share on November 29, 2013) and expire three years from the date of issuance. The Company also issued warrants to purchase 54,650 ordinary shares to the placement agent ("Placement Agent Warrant"). The Placement Agent Warrants are on substantially the same terms as the warrants issued pursuant to the Purchase Agreement, except that these warrants are not exercisable for a period of six months and will expire three years from the initial exercise date.

In addition to the above warrants issued to the placement agent, the Company granted warrants for 170,000 shares in connection with its IPO offering, and none of these warrants was exercised during this period.

Appropriated Retained Earnings - According to the Memorandum and Articles of Association, the Company is required to transfer a certain portion of its net profit, as determined under PRC accounting regulations, from current net income to the statutory reserve fund. In accordance with the PRC Company Law, companies are required to transfer 10% of their profit after tax, as determined in accordance with PRC accounting standards and regulations, to the statutory reserves until such reserves reach 50% of the registered capital or paid-in capital of the companies. As of June 30, 2013 and March 31, 2014, the balance of total statutory reserves was ¥3,023,231 and ¥4,868,048 ($790,024), respectively.

NOTE 15. STOCK-BASED COMPENSATION

Stock-Based Awards Plan

2009 Options Plan - The Company granted options to purchase 293,000 ordinary shares under the Stock Incentive 2009 Plan to its employees and non-employee directors on July 29, 2009. The options have an excise price of $6.00, equal to the IPO price of the Company's ordinary shares, and will vest over a period of five years, with the first 20% vesting on July 29, 2010. The options expire ten years after the date of grant, on July 29, 2019. The fair value was estimated on July 29, 2009 using the Binomial Lattice valuation model, with the following weighted-average assumptions:

Stock price at grant date	$6.00	
Exercise price (per share)	$6.00	
Risk free rate of interest***	4.6118	%
Dividend yield	0.0	%
Life of option (years)**	10	
Volatility*	78	%
Forfeiture rate****	0	%

* Volatility is projected using the performance of PHLX Oil Service Sector index.

** The life of options represents the period the option is expected to be outstanding.

*** The risk-free interest rate is based on the Chinese international bond denominated in U.S. dollar, with a maturity that approximates the life of the option.

**** Forfeiture rate is the estimated percentage of options forfeited by employees by leaving or being terminated before vesting.

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The Company recognizes compensation cost for awards with graded vesting on a straight-line basis over the requisite service period for the entire award. The grant date fair value of the options was ¥30.17 ($4.42) per share.

2012 Options Plan – The Company granted options to purchase 415,000 ordinary shares to its employees and a non-employee director on March 26, 2012. The options have an excise price of $2.96, which was equal to the share price of the Company's ordinary shares at March 26, 2012, and will vest over a period of five years, with the first 20% vesting on March 26, 2013. The options expire ten years after the date of grant, on March 26, 2022.

The Company recognizes compensation cost for awards with graded vesting on a straight-line basis over the requisite service period for the entire award. The grant date fair value of the options was ¥10.06 ($1.49) per share.

The following is a summary of the stock options activity:

Stock Options	Shares	Weighted Average Exercise Price Per Share		
Outstanding as of July 1, 2013	608,000	$	3.93	
Granted	-		-	
Forfeited	(44,000)		(2.96	)
Exercised	-		-	
Outstanding as of March 31, 2014	564,000	$	4.00	

The following is a summary of the status of options outstanding and exercisable at March 31, 2014:

Outstanding Options			Exercisable Options		
Average Exercise Price	Number	Average Remaining Contractual life (Years)	Average Exercise Price	Number	Average Remaining Contractual life (Years)
$6.00	193,000	5.33	$6.00	154,400	5.33
$2.96	371,000	7.99	$2.96	148,400	7.99

During the three and nine months ended March 31, 2014, the Company has granted restricted shares of common stock to senior management and consultants as follow:

On October 31, 2013, the Company issued 30,000 restricted shares to a consulting firm for consulting services. The total value amounted to ¥407,972 ($66,420), based on the stock closing price of $2.21 at September 30, 2013.

On December 13, 2013, the Company granted 95,181 restricted shares to Mr. Yin Shenping and 135,181 restricted shares to Mr. Chen Guangqiang at an aggregate value of ¥4,207,496 ($688,782), based on the stock closing price of $2.99 at December 13, 2013. These restricted shares will be vested over three years with one third of the shares vesting every year from the grant date. Share-based compensation expense recorded for restricted shares granted were ¥352,324 ($57,399) and ¥418,553 ($68,241) for the three and nine months ended March 31, 2014. Total unrecognized share-based compensation expense for these shares as of March 31, 2014 was approximately ¥3.8 million ($0.6 million), which are expected to be recognized over a weighted average period of approximately 2.71 years.

The Share-based compensation expense recorded for stock options granted were ¥451,573 and ¥412,311 ($67,476) for the three months ended March 31, 2013 and 2014, respectively. The total share-based compensation expense recorded for stock options granted were ¥1,358,726 and ¥1,660,144 ($269,421) for the nine months ended March 31, 2013 and 2014, respectively. The total unrecognized share-based compensation expense for stock options as of March 31, 2014 was approximately ¥2.7 million ($0.5 million), which is expected to be recognized over a weighted average period of approximately 2.66 years.

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Following is a summary of the restricted stock grants:

Restricted stock grants	Shares
Nonvested as of June 30, 2013	-
Granted	260,362
Forfeited	-
Vested	(30,000)
Nonvested as of March 31, 2014	230,362

NOTE 16. INCOME TAX

The Company is not subject to any income taxes in the United States or the Cayman Islands and had minimal operations in jurisdictions other than the PRC. BHD and Nanjing Recon are subject to PRC's income taxes as PRC domestic companies. For the calendar years 2013 and 2014, Nanjing Recon is subject to an income tax rate of 15%.

As approved by the domestic tax authority in the PRC, BHD was recognized as a government-certified high technology company on November 25, 2009 and is subject to an income tax rate of 15% through November 2015.

Deferred tax assets are comprised of the following:

	June 30, 2013 RMB	March 31, 2014 RMB	March 31, 2014 U.S. Dollars
Allowance for doubtful receivables	¥1,006,721	¥1,082,436	$175,666

Total deferred income tax assets	¥1,006,721	¥1,082,436	$175,666

The Company’s tax provision (benefit) is comprised of the following:

	For the three months ended March 31,		
	2013	2014	2014
	RMB	RMB	U.S. Dollars
Current income tax provision (benefit)	¥(158,721)	¥194,291	$31,531
Deferred income taxes provision (benefit)	6,339	(43,504)	(7,060)
Provision (benefit) for income tax	¥(152,382)	¥150,787	$24,471

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	For the nine months ended March 31,		
	2013	2014	2014
	RMB	RMB	U.S. Dollars
Current income taxes	¥290,187	¥1,685,691	$273,567
Deferred income taxes provision (benefit)	12,363	(75,715)	(12,288)
Provision for income tax	¥302,550	¥1,609,976	$261,279

NOTE 17. NON-CONTROLLING INTEREST

Non-controlling interest consisted of the following:

	As of June 30, 2013			
	BHD	Nanjing Recon	Total	Total
	RMB	RMB	RMB	U.S. Dollars
Paid-in capital	¥1,651,000	¥200,000	¥1,851,000	$299,118
Unappropriated retained earnings	2,717,231	2,665,337	5,382,568	869,812
Accumulated other comprehensive loss	(18,793)	(13,784)	(32,577)	(5,265)
Total non-controlling interest	¥4,349,438	¥2,851,553	¥7,200,991	$1,163,665

As of
March
31, 2014
$4,041

Loss on Extinguishment of Debt

The components of loss on extinguishment of debt consist of the following:

	For the Three Months Ended March 30, 2014	For the Three Months Ended March 24, 2013	For the Nine Months Ended March 30, 2014	For the Nine Months Ended March 24, 2013
Prepayment call premium and other costs for Term B Loan	$—	$ 470	$—	$671
Non-cash charges due to write-off of debt financing fees	—	276	—	431
Loss on extinguishment of debt	$—	$ 746	$—	$1,102

13. Other Long-Term Liabilities

Other long-term liabilities consist of the following:

	March 30, 2014	June 30, 2013
Supplemental post-employment plan	$2,940	$2,665
Contingent consideration	2,025	—
Income tax contingencies	1,233	1,275
Derivative instruments	217	324
Severance	—	137
Other	964	652
Total other long-term liabilities	$7,379	$5,053

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

Contingent consideration represents the present value of the long-term portion of contingent payments associated with the Company's December 2013 acquisition of Dillon's draw winding business. See "Note 17. Fair Value of Financial Instruments and Non-Financial Assets and Liabilities" for further discussion. Severance represents the long-term portion of monies due under severance agreements with former executive officers of the Company. See "Note 20. Other Operating Expense, Net" for further discussion of these charges. Other primarily includes certain employee related liabilities and deferred energy incentive credits.

The Company maintains an unfunded supplemental post-employment plan for certain management employees. Each employee's account is credited annually based upon a percentage of the participant's base salary, with each participant's balance adjusted quarterly to reflect returns based upon a stock market index. Amounts are paid to participants only after termination of employment. The following table presents the expenses recorded for this plan:

	For the Three Months Ended		**For the Nine Months Ended**	
Classification	**March 30, 2014**	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Selling general and administrative expenses	$ 118	$ 303	$ 547	$ 609
Other operating expense, net	(14)	—	77	—
Total	$ 104	$ 303	$ 624	$ 609

14. Income Taxes

The effective income tax rates for the three month and nine month periods ended March 30, 2014 and March 24, 2013 were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be impacted over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections and changes in foreign currency exchange rates in relation to the U.S. dollar. As a result, the Company's effective tax rate may fluctuate significantly on a quarterly basis.

The Company's effective tax rate for the three month and nine month periods ending March 30, 2014 was 50.1% and 42.3%, respectively, and its effective tax rate for the three month and nine month periods ending March 24, 2013 was 68.3% and 59.4%, respectively. The Company's effective tax rate for each of the periods presented was higher than the U.S. federal statutory rate primarily due to the unfavorable effects of foreign dividends taxed in the U.S., the impact of state taxes, the timing of the Company's recognition of higher taxable versus book income for an unconsolidated affiliate for which the Company maintains a full valuation allowance, and losses in tax jurisdictions for which no tax benefit could be recognized.

As of March 30, 2014, the Company's valuation allowance was $18,147 and includes $15,115 related to reserves against certain deferred tax assets for unconsolidated affiliates and foreign tax credit carryforwards, as well as $3,032 for reserves against certain deferred tax assets of the Company's foreign subsidiaries that are primarily related to net operating loss carryforwards. The Company's valuation allowance as of June 30, 2013 was $16,690.

There have been no significant changes in the Company's liability for uncertain tax positions since June 30, 2013. The Company's estimate for the potential outcome for any uncertain tax issue is highly judgmental. Management believes that any reasonably foreseeable outcomes related to these matters have been adequately provided for. However, future results may include favorable or unfavorable adjustments to estimated tax liabilities in the period the assessments are made or resolved or when statutes of limitation on potential assessments expire.

The Company and its domestic subsidiaries file a consolidated federal income tax return, as well as income tax returns in numerous state and foreign jurisdictions. The tax years subject to examination vary by jurisdiction. The Company regularly assesses the outcomes of both completed and ongoing examinations to ensure that the Company's provision for income taxes is sufficient. Currently, the Company is subject to examinations for U.S. federal income taxes for tax years 2010 through 2013, for foreign income taxes for tax years 2007 through 2013, and for state and local income taxes for tax years 2003 through 2013. The U.S. federal tax returns and state tax returns filed for the 2010 through 2013 tax years have utilized carryforward tax attributes generated in prior tax years, including net operating losses, which could potentially be revised upon examination.

15. Shareholders' Equity

On January 22, 2013, the Board approved a stock repurchase program (the "2013 SRP") to acquire up to $50,000 of the Company's common stock. As of March 30, 2014, the Company had completed its repurchase of shares under the 2013 SRP.

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

The following table summarizes the Company's repurchases and retirements of its common stock since the inception of the 2013 SRP:

	Total Number of Shares Repurchased as Part of Publicly Announced Plans or Programs	**Average Price Paid per Share**	**Maximum Approximate Dollar Value that May Yet Be Repurchased Under the Plans or Programs**
Fiscal year 2013	1,068	$ 18.08	
Fiscal year 2014	1,273	$ 24.11	
Total	2,341	$ 21.36	$ —

All repurchased shares have been retired and have the status of authorized and unissued shares. The cost of the repurchased shares is recorded as a reduction to common stock to the extent of the par value of the shares acquired and the remainder is allocated between capital in excess of par value and retained earnings. The portion of the remainder that is allocated to capital in excess of par value is limited to a pro rata portion of capital in excess of par value.

Subsequent Event

On April 23, 2014, the Board approved a new stock repurchase program (the "2014 SRP") to acquire up to an additional $50,000 of the Company's common stock. Under the 2014 SRP, the Company has been authorized to repurchase shares at prevailing market prices, through open market purchases or privately negotiated transactions at such times, manner and prices as determined by management, subject to market conditions, applicable legal requirements, contractual obligations and other factors. Repurchases are expected to be financed through cash generated from operations and borrowings under the Company's ABL Revolver, and are subject to applicable limitations and restrictions as set forth in the ABL Facility. The repurchase program has no stated expiration or termination date, and there is no time limit or specific time frame otherwise for repurchases. The Company may discontinue repurchases at any time that management determines additional purchases are not beneficial or advisable.

No dividends were paid during the last two fiscal years.

16. Stock Based Compensation

On October 23, 2013, the Company's shareholders approved the Unifi, Inc. 2013 Incentive Compensation Plan (the "2013 Plan"). The 2013 Plan replaced the 2008 Unifi, Inc. Long-Term Incentive Plan ("2008 LTIP"). No additional awards will be granted under the 2008 LTIP; however, prior awards outstanding under the 2008 LTIP remain subject to that plan's provisions. The 2013 Plan authorized the issuance of 1,000 shares of common stock, subject to certain increases in the event outstanding awards under the 2008 LTIP expire, are forfeited or otherwise terminate unexercised.

Stock options

During the nine months ended March 30, 2014 and March 24, 2013, the Company granted stock options to purchase 97 and 138 shares of common stock, respectively, to certain key employees. The stock options vest ratably over the required three year service period. For the nine months ended March 30, 2014 and March 24, 2013, the weighted average exercise price of the options granted was $22.31 and $11.15 per share, respectively. The Company used the Black-Scholes model to estimate the weighted average grant date fair value of $14.66 and $7.28 per share, respectively.

The valuation models used the following assumptions:

	For the Nine Months Ended	
	March 30, 2014	**March 24, 2013**
Expected term (years)	7.4	7.5
Interest rate	2.1%	1.0%
Volatility	65.9%	66.9%
Dividend yield	—	—

The Company uses historical data to estimate the expected term, volatility and forfeitures. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant for periods corresponding with the expected term of the options.

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

A summary of stock option activity for the nine months ended March 30, 2014 is as follows:

	Stock Options	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life (Years)**	**Aggregate Intrinsic Value**
Outstanding at June 30, 2013	1,541	$ 8.41		
Granted	97	$ 22.31		
Exercised	(788)	$ 8.41		
Forfeited	(33)	$ 13.69		
Expired	(7)	$ 20.55		
Outstanding at March 30, 2014	810	$ 9.75	6.1	$ 10,364
Vested and expected to vest as of March 30, 2014	805	$ 9.71	6.1	$ 10,343
Exercisable at March 30, 2014	598	$ 7.56	5.3	$ 8,952

At March 30, 2014, the remaining unrecognized compensation cost related to unvested stock options was $989, which is expected to be recognized over a weighted average period of 2.1 years.

For the nine month periods ended March 30, 2014 and March 24, 2013, the total intrinsic value of options exercised was $12,826, and $123, respectively. The amount of cash received from the exercise of options was $3,056 and $78 for the nine month periods ended March 30, 2014 and March 24, 2013, respectively. The tax benefit realized from stock options exercised was $4,930 and $20 for the nine month periods ended March 30, 2014 and March 24, 2013, respectively. During the second quarter of the 2014 fiscal year, the Company received and retired 134 shares of its common stock, with a fair value of $3,583, tendered in lieu of cash for the exercise of stock options.

Restricted stock units

During the nine months ended March 30, 2014 and March 24, 2013, the Company granted 22 and 32 restricted stock units (“RSUs”), respectively, to certain key employees. The RSUs are subject to a vesting restriction and convey no rights of ownership in shares of Company stock until such RSUs have vested and been distributed to the grantee in the form of Company stock. The RSUs vest over a three year period, and will be converted into an equivalent number of shares of stock (for distribution to the grantee) on each vesting date, unless the grantee has elected to defer the receipt of the shares of stock until separation from service. If, after the first anniversary of the grant date and prior to the final vesting date, the grantee has a separation from service without cause for any reason other than the employee's resignation, the remaining unvested RSUs will become fully vested and will be converted to an equivalent number of shares of stock and issued to the grantee. The Company estimated the fair value of the awards granted during the nine months ended March 30, 2014 and March 24, 2013 to be $22.08 and $11.23 per RSU, respectively.

During the nine months ended March 30, 2014 and March 24, 2013, the Company granted 25 and 30 RSUs, respectively, to the Company's non-employee directors. The RSUs became fully vested on the grant date. The RSUs convey no rights of ownership in shares of Company stock until such RSUs have been distributed to the grantee in the form of Company stock. The vested RSUs will be converted into an equivalent number of shares of Company common stock and distributed to the grantee following the grantee's termination of service as a member of the Board. The grantee may elect to defer receipt of the shares of stock in accordance with the deferral options provided under the Unifi, Inc. Director Deferred Compensation Plan. The Company estimated the fair value of the awards granted during the nine months ended March 30, 2014 and March 24, 2013 to be $23.23 and $13.57 per RSU, respectively.

The Company estimates the fair value of RSUs based on the market price of the Company's common stock at the award grant date.

A summary of the RSU activity for the nine months ended March 30, 2014 is as follows:

	Non-vested	**Weighted Average Grant Date Fair Value**	**Vested**	**Total**	**Weighted Average Grant Date Fair Value**
Outstanding at June 30, 2013	75	$ 11.94	112	187	$ 11.78
Granted	47	$ 22.68	—	47	$ 22.68
Vested	(71)	$ 15.96	71	—	$ 15.96
Converted	—	$ —	(31)	(31)	$ 12.06
Forfeited	(2)	$ 22.08	—	(2)	$ 22.08
Outstanding at March 30, 2014	49	$ 16.11	152	201	$ 14.19

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

At March 30, 2014, the number of RSUs vested and expected to vest was 201, with an aggregate intrinsic value of $4,535. The aggregate intrinsic value of the 152 vested RSUs at March 30, 2014 was $3,427.

The remaining unrecognized compensation cost related to the unvested RSUs at March 30, 2014 is $320, which is expected to be recognized over a weighted average period of 2.2 years.

For the nine month periods ended March 30, 2014 and March 24, 2013, the total intrinsic value of RSUs converted was $696 and $114, respectively. The tax benefit realized from the conversion of RSUs was $275 and $45 for the nine months ended March 30, 2014 and March 24, 2013, respectively.

Summary

The total cost charged against income related to all stock-based compensation arrangements was as follows:

	For the Three Months Ended		**For the Nine Months Ended**	
	March 30, 2014	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Stock options	$280	$ 217	$718	$676
RSUs	82	50	855	611
Total compensation cost	$362	$ 267	$1,573	$1,287

The total income tax benefit recognized for stock based compensation was $444 and $329 for the nine months ended March 30, 2014 and March 24, 2013, respectively.

As of March 30, 2014, a summary of the number of securities currently available for future issuance under equity compensation plans is as follows:

Authorized under the 2013 Plan	1,000
Plus: Awards expired, forfeited or otherwise terminated unexercised from the 2008 LTIP	—
Less: Service condition options granted	(5)
Less: RSUs granted to non-employee directors	(25)
Available for issuance under the 2013 Plan	970

17. Fair Value of Financial Instruments and Non-Financial Assets and Liabilities

Financial Instruments

The Company uses derivative financial instruments, such as foreign currency contracts or interest rate swaps, to reduce its ongoing business exposures to fluctuations in foreign currency exchange rates or interest rates. The Company does not enter into derivative contracts for speculative purposes.

Foreign currency contracts

The Company enters into foreign currency contracts as economic hedges for exposures related to certain sales, inventory purchases and equipment purchases that are denominated in currencies that are not its functional currency. As of March 30, 2014, the latest maturity date for all outstanding foreign currency contracts is during July 2014. These items are not designated as hedges by the Company and are marked to market each period and offset by the foreign exchange (gains) losses included in other operating expense, net resulting from the underlying exposures of the foreign currency denominated assets and liabilities.

Interest rate swap

On May 18, 2012, the Company entered into a five year, $50,000 interest rate swap with Wells Fargo to provide a hedge against the variability of cash flows related to LIBOR-based variable rate borrowings under the Company's ABL Revolver and ABL Term Loan. The swap increased to $85,000 in May 2013 and began decreasing $5,000 per quarter in August 2013 and will continue to do so until the balance again reaches $50,000 in February 2015, where it will remain through the life of the instrument. This interest rate swap allows the Company to fix LIBOR at 1.06% and terminates on May 24, 2017.

On November 26, 2012, the Company de-designated this interest rate swap as a cash flow hedge. For the year-to-date period ended March 30, 2014, the Company reclassified pre-tax unrealized losses of $433 from accumulated other comprehensive loss to interest expense; the Company expects to reclassify additional losses of $386 during the next twelve months.

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

Contingent consideration

On December 2, 2013, the Company acquired certain assets in a business combination with Dillon and recorded a contingent consideration liability, as described in “Note 4. Acquisition.” The fair value of the contingent consideration is measured at each reporting period using a discounted cash flow methodology based on inputs not observable in the market (Level 3 classification in the fair value hierarchy) and any change in the fair value from either the passage of time or events occurring after the acquisition date is recorded in other operating expense, net in the consolidated statements of income. As of March 30, 2014, the inputs and assumptions used to develop the fair value measurement have not changed since the acquisition date.

A reconciliation of the changes in the fair value follows:

Contingent consideration as of December 29, 2013	$2,500
Change in fair value	98
Payment	(11)
Contingent consideration as of March 30, 2014	$2,587

Based on the present value of the expected future payments, the Company has recorded a liability of $562 in accrued expenses and $2,025 in other long-term liabilities.

The Company’s financial assets and liabilities accounted for at fair value on a recurring basis, and the level within the fair value hierarchy used to measure these items, are as follows:

As of March 30, 2014	**Notional Amount**		**USD Equivalent**	**Balance Sheet Location**	**Fair Value Hierarchy**	**Fair Value**
Foreign currency contracts	MXN	1,200	$ 91	Accrued expenses	Level 2	$ (1)
	EUR	495	$ 667	Other current assets	Level 2	$ 14

Foreign currency contracts						
Interest rate swap	USD	$ 70,000	$ 70,000	Other long-term liabilities	Level 2	$ (217)
Contingent consideration				Accrued expenses and other long-term liabilities	Level 3	$ (2,587)

As of June 30, 2013	Notional Amount		USD Equivalent	Balance Sheet Location	Fair Value Hierarchy	Fair Value
Foreign currency contracts	MXN	3,800	$ 295	Other current assets	Level 2	$ 3
Interest rate swap	USD	$ 85,000	$ 85,000	Other long-term liabilities	Level 2	$ (324)

(MXN represents the Mexican Peso; EUR represents the Euro)

Estimates of the fair value of the Company's foreign currency contracts and interest rate swaps are obtained from month-end market quotes for contracts with similar terms.

The effect of marked to market hedging derivative instruments was as follows:

Derivatives not designated as hedges	Classification	For the Three Months Ended March 30, 2014	March 24, 2013
Foreign currency contracts	Other operating expense, net	$ 3	$ 15
Interest rate swap	Interest expense	(99)	(103)
Total gain recognized in income		$ (96)	$ (88)

Derivatives not designated as hedges	Classification	For the Nine Months Ended March 30, 2014	March 24, 2013
Foreign currency contracts	Other operating expense, net	$ (19)	$ 53
Interest rate swap	Interest expense	(107)	(177)
Total gain recognized in income		$ (126)	$ (124)

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

By entering into derivative instrument contracts, the Company exposes itself to counterparty credit risk. The Company attempts to minimize this risk by selecting counterparties with investment grade credit ratings, limiting the amount of exposure to any single counterparty and regularly monitoring its market position with each counterparty. The Company's derivative instruments do not contain any credit risk related contingent features.

Since its most recent debt refinancing and modification, the Company believes that there have been no significant changes to its credit risk profile or the interest rates available to the Company for debt issuances with similar terms and average maturities, and the Company estimates that the fair values of its long-term debt obligations approximate their carrying amounts. Other financial instruments include cash and cash equivalents, receivables, accounts payable and accrued expenses. The financial statement carrying amounts of these items approximate their fair value because of their short-term nature.

There were no transfers into or out of the levels of the fair value hierarchy for the periods ended March 30, 2014 or March 24, 2013.

Non-Financial Assets and Liabilities

The Company did not have any non-financial assets or liabilities that were required to be measured at fair value on a recurring basis.

18. Accumulated Other Comprehensive Loss

The components of and the changes in accumulated other comprehensive loss consist of the following:

	Foreign	Unrealized	Accumulated

	Currency Translation Adjustments	(Loss) Gain On Interest Rate Swap	Other Comprehensive Loss
Balance at June 30, 2013	$ (4,568)	$ (932)	$ (5,500)
Other comprehensive (loss) income, net	(1,612)	433	(1,179)
Balance at March 30, 2014	$ (6,180)	$ (499)	$ (6,679)

Other comprehensive income (loss) for the three months ended March 30, 2014 and March 24, 2013 is provided as follows:

	For the Three Months Ended March 30, 2014		
	Pre-tax	Tax	After-tax
Foreign currency translation adjustments	$1,850	$ —	$ 1,850
Reclassification adjustment for interest rate swap included in net income	133	—	133
Other comprehensive income, net	$1,983	$ —	$ 1,983

	For the Three Months Ended March 24, 2013		
	Pre-tax	Tax	After-tax
Foreign currency translation adjustments	$891	$—	$ 891
Loss on cash flow hedges for an unconsolidated affiliate	(14)	—	(14)
Gain on interest rate swaps	86	(33)	53
Reclassification adjustment for interest rate swap included in net income	106	(43)	63
Other comprehensive income, net	$1,069	$(76)	$ 993

Other comprehensive (loss) income for the nine months ended March 30, 2014 and March 24, 2013 is provided as follows:

	For the Nine Months Ended March 30, 2014		
	Pre-tax	Tax	After-tax
Foreign currency translation adjustments	$(1,612)	$ —	$ (1,612)
Reclassification adjustment for interest rate swap included in net income	433	—	433
Other comprehensive loss, net	$(1,179)	$ —	$ (1,179)

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

	For the Nine Months Ended March 24, 2013		
	Pre-tax	Tax	After-tax
Foreign currency translation adjustments	$227	$—	$ 227
Gain on cash flow hedges for an unconsolidated affiliate	1,214	—	1,214
Loss on interest rate swaps	(299)	119	(180)
Reclassification adjustment for interest rate swap included in net income	198	(79)	119
Other comprehensive income, net	$1,340	$40	$ 1,380

19. Computation of Earnings Per Share

The computation of basic and diluted earnings per share ("EPS") is as follows:

	For the Three Months Ended		For the Nine Months Ended	
	March 30, 2014	March 24, 2013	March 30, 2014	March 24, 2013
Basic EPS				
Net income attributable to Unifi, Inc.	$4,743	$1,399	$20,056	$6,119
Weighted average common shares outstanding	18,825	20,082	19,075	20,091
Basic EPS	$0.25	$0.07	$1.05	$0.30
Diluted EPS				
Net income attributable to Unifi, Inc.	$4,743	$1,399	$20,056	$6,119
Weighted average common shares outstanding	18,825	20,082	19,075	20,091
Net potential common share equivalents – stock options and RSUs	581	598	748	540
Adjusted weighted average common shares outstanding	19,406	20,680	19,823	20,631
Diluted EPS	$0.24	$0.07	$1.01	$0.30

As of March 30, 2014 and March 24, 2013, the number of anti-dilutive common share equivalents excluded from the calculation of diluted shares was 91 and 272, respectively, and the number of unvested options that vest upon achievement of certain market conditions excluded from the calculation of diluted shares was 13 and 560, respectively.

The calculation of earnings per common share is based on the weighted average number of the Company’s common shares outstanding for the applicable period. The calculation of diluted earnings per common share presents the effect of all potential dilutive common shares that were outstanding during the respective periods, unless the effect of doing so is anti-dilutive. Common share equivalents where the exercise price is above the average market price are excluded in the calculation of diluted earnings per common share.

20. Other Operating Expense, Net

The components of other operating expense, net consist of the following:

	For the Three Months Ended		**For the Nine Months Ended**	
	March 30, 2014	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Operating expenses for Renewables	$719	$ 582	$1,923	$1,686
Restructuring charges, net	178	—	1,296	—
Foreign currency transaction losses (gains)	195	(20)	368	37
Net (gain) loss on sale or disposal of assets	(71)	105	269	184
Other, net	218	(51)	152	(130)
Other operating expense, net	$1,239	$ 616	$4,008	$1,777

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

Operating expenses for Renewables include amounts incurred for employee costs, land and equipment rental costs, operating supplies, product testing, and administrative costs. Operating expenses for Renewables also includes $87 and $55 of depreciation and amortization expense for the three months ended March 30, 2014 and March 24, 2013, respectively, and $247 and $146 for the nine months ended March 30, 2014 and March 24, 2013, respectively.

The components of restructuring charges, net consist of the following:

	For the Three Months Ended		For the Nine Months Ended	
	March 30, 2014	March 24, 2013	March 30, 2014	March 24, 2013
Severance	$171	$ —	$940	$ —
Equipment relocation and reinstallation costs	7	—	356	—
Restructuring charges, net	$178	$ —	$1,296	$ —

Severance

On May 14, 2013, the Company and one of its executive officers entered into a severance agreement that will provide severance and certain other benefits through November 30, 2014. On August 12, 2013, the Company and another of its executive officers entered into a severance agreement that will provide severance and certain other benefits through December 12, 2014. The table below presents changes to accrued severance for the nine months ended March 30, 2014:

	Balance June 30, 2013	Charged to expense	Charged to other accounts	Payments	Adjustments	Balance March 30, 2014
Accrued severance	$ 1,186	940	243	(1,721)	—	$ 648

Equipment Relocation and Reinstallation Costs

During the first quarter of fiscal year 2014, the Company began the relocation of certain equipment within the Polyester Segment as follows:

The Company began to dismantle and relocate certain polyester draw warping equipment from Monroe, North Carolina to a Burlington, North Carolina facility.

The Company also began to dismantle and relocate certain polyester texturing and twisting equipment between locations in North Carolina and El Salvador.

The relocation of this equipment was completed during the second quarter of fiscal year 2014. The costs incurred for the relocation of equipment were charged to restructuring expense as incurred.

21. Investments in Unconsolidated Affiliates and Variable Interest Entities

Parkdale America, LLC

In June 1997, the Company and Parkdale Mills, Inc. (“Mills”) entered into a Contribution Agreement that set forth the terms and conditions by which the two companies contributed all of the assets of their spun cotton yarn operations utilizing open-end and air-jet spinning technologies to create Parkdale America, LLC (“PAL”). In exchange for its contribution, the Company received a 34% ownership interest in PAL, which is accounted for using the equity method of accounting. Effective January 1, 2012, Mills’ interest in PAL was assigned to Parkdale Incorporated. PAL is a limited liability company treated as a partnership for income tax reporting purposes, and PAL’s fiscal year end is the Saturday nearest to December 31. PAL is a producer of cotton and synthetic yarns for sale to the textile industry and apparel market, both foreign and domestic. PAL has 13 manufacturing facilities located primarily in the southeast region of the U.S. According to its most recently issued audited financial statements, PAL’s five largest customers accounted for approximately 74% of total revenues and 78% of total gross accounts receivable outstanding.

During August 2008, a federal government program commenced providing economic adjustment assistance to domestic users of upland cotton (the “EAP program”). The EAP program offered a subsidy for cotton consumed in domestic production, and the subsidy is paid the month after the eligible cotton is consumed. The subsidy must be used within eighteen months after the marketing year in which it is earned to purchase qualifying capital expenditures in the U.S. for production of goods from upland cotton. The marketing year is from August 1 to July 31. The program provided a subsidy of four cents per pound through July 31, 2012 and thereafter provides a subsidy of three cents per pound. In February 2014, the federal government extended the EAP program for five years. The cotton subsidy will remain at three cents per pound for the life of the program. The Company recognizes its share of PAL’s income for the cotton subsidy when the cotton has been consumed and the qualifying assets have been acquired, with an appropriate allocation methodology considering the dual criteria of the subsidy.

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

As of March 30, 2014, the Company's investment in PAL was $94,752 and shown within investments in unconsolidated affiliates in the Condensed Consolidated Balance Sheets. The reconciliation between the Company's share of the underlying equity of PAL and its investment is as follows:

Underlying equity as of March 2014	$113,173
Initial excess capital contributions	53,363
Impairment charge recorded by the Company in 2007	(74,106)
Antitrust lawsuit against PAL in which the Company did not participate	2,652
EAP adjustments	(330)
Investment balance as of March 2014	$94,752

U.N.F. Industries, Ltd.

In September 2000, the Company and Nilit Ltd. ("Nilit") formed a 50/50 joint venture, U.N.F. Industries Ltd. ("UNF"), for the purpose of operating nylon extrusion assets to manufacture nylon POY. All raw material and production services for UNF are provided by Nilit under separate supply and services agreements. UNF's fiscal year end is December 31 and it is a registered Israeli private company located in Migdal Ha-Emek, Israel.

UNF America, LLC

In October 2009, the Company and Nilit America Inc. ("Nilit America") formed a 50/50 joint venture, UNF America LLC ("UNF America"), for the purpose of operating a nylon extrusion facility which manufactures nylon POY. All raw material and production services for UNF America are provided by Nilit America under separate supply and services agreements. UNF America's fiscal year end is December 31 and it is a limited liability company treated as a partnership for income tax reporting purposes located in Ridgeway, Virginia.

In conjunction with the formation of UNF America, the Company entered into a supply agreement with UNF and UNF America whereby the Company agreed to purchase all of its first quality nylon POY requirements for texturing (subject to certain exceptions) from either UNF or UNF America. The agreement has no stated minimum purchase quantities and pricing is negotiated every six months, based on market rates. As of March 30, 2014, the Company's open purchase orders related to this agreement were $3,060.

The Company's raw material purchases under this supply agreement consist of the following:

	For the Nine Months Ended	
	March 30, 2014	March 24, 2013
UNF	$8,177	$8,792
UNF America	18,065	16,936
Total	$26,242	$25,728

As of March 30, 2014 and June 30, 2013, the Company had combined accounts payable due to UNF and UNF America of $3,621 and $2,890, respectively.

The Company has determined that UNF and UNF America are variable interest entities ("VIEs") and has also determined that the Company is the primary beneficiary of these entities, based on the terms of the supply agreement. As a result, these entities should be consolidated in the Company's financial results. As the Company purchases substantially all of the output from the two entities, the two entities' balance sheets constitute 3% or less of the Company's current assets, total assets and total liabilities, and such balances are not expected to comprise a larger portion in the future, the Company has not included the accounts of UNF and UNF America in its consolidated financial statements. As of March 30, 2014, the Company's combined investments in UNF and UNF America were $3,678 and are shown within investments in unconsolidated affiliates in the Condensed Consolidated Balance Sheets. The financial results of UNF and UNF America are included in the Company's financial statements with a one month lag, using the equity method of accounting and with intercompany profits eliminated in accordance with the Company's accounting policy. Other than the supply agreement discussed above, the Company does not provide any other commitments or guarantees related to either UNF or UNF America.

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Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

Condensed balance sheet and income statement information for the Company’s unconsolidated affiliates is presented in the following tables. As PAL is defined as significant, its information is separately disclosed.

	As of March 30, 2014		
	PAL	**Other**	**Total**
Current assets	$268,929	$8,300	$277,229
Noncurrent assets	123,184	3,087	126,271
Current liabilities	48,170	4,180	52,350
Noncurrent liabilities	11,081	—	11,081
Shareholders’ equity and capital accounts	332,862	7,207	340,069
The Company’s portion of undistributed earnings	24,120	769	24,889

	As of June 30, 2013		
	PAL	**Other**	**Total**
Current assets	$266,300	$11,343	$277,643
Noncurrent assets	111,061	3,163	114,224
Current liabilities	44,517	4,910	49,427
Noncurrent liabilities	15,609	—	15,609
Shareholders’ equity and capital accounts	317,235	9,596	326,831

	For the Three Months Ended March 30, 2014		
	PAL	**Other**	**Total**
Net sales	$211,657	$8,631	$220,288
Gross profit	13,560	1,161	14,721
Income from operations	8,394	741	9,135
Income to members	9,453	781	10,234
Depreciation and amortization	5,485	25	5,510
Cash received by PAL under EAP program	3,836	—	3,836
Earnings recognized by PAL for EAP program	3,836	—	3,836
Dividends and cash distributions received	6,023	750	6,773

As of the end of PAL's fiscal March 2014 period, PAL's amount of deferred revenues related to the EAP program was $0.

	For the Three Months Ended March 24, 2013		
	PAL	**Other**	**Total**
Net sales	$197,242	$8,188	$205,430
Gross profit	20,956	944	21,900
Income from operations	12,053	549	12,602
Income to members	12,553	573	13,126
Depreciation and amortization	6,577	25	6,602
Cash received by PAL under EAP program	4,439	—	4,439
Earnings recognized by PAL for EAP program	2,576	—	2,576
Dividends and cash distributions received	7,807	—	7,807

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

	For the Nine Months Ended March 30, 2014		
	PAL	Other	Total
Net sales	$624,823	$26,542	$651,365
Gross profit	50,315	3,286	53,601
Income from operations	38,314	1,990	40,304
Income to members	40,869	2,110	42,979
Depreciation and amortization	19,771	75	19,846
Cash received by PAL under EAP program	11,329	—	11,329
Earnings recognized by PAL for EAP program	20,120	—	20,120
Dividends and cash distributions received	8,582	1,250	9,832

	For the Nine Months Ended March 24, 2013		
	PAL	Other	Total
Net sales	$567,854	$26,423	$594,277
Gross profit	30,445	4,322	34,767
Income from operations	12,823	3,053	15,876
Income to members	14,439	3,068	17,507
Depreciation and amortization	22,577	75	22,652
Cash received by PAL under EAP program	13,208	—	13,208
Earnings recognized by PAL for EAP program	6,444	—	6,444
Dividends and cash distributions received	10,031	500	10,531

22. Commitments and Contingencies

Collective Bargaining Agreements

While employees of the Company’s foreign operations are generally unionized, none of the Company’s domestic labor force is currently covered by a collective bargaining agreement.

Environmental

On September 30, 2004, the Company completed its acquisition of the polyester filament manufacturing assets located in Kinston, North Carolina from INVISTA S.a.r.l ("Invista"). The land for the Kinston site was leased pursuant to a 99 year ground lease ("Ground Lease") with E.I. DuPont de Nemours ("DuPont"). Since 1993, DuPont has been investigating and cleaning up the Kinston site under the supervision of the U.S. Environmental Protection Agency ("EPA") and the North Carolina Department of Environment and Natural Resources ("DENR") pursuant to the Resource Conservation and Recovery Act Corrective Action program. The Corrective Action program requires DuPont to identify all potential areas of environmental concern ("AOCs"), assess the extent of containment at the identified AOCs and to clean it up to comply with applicable regulatory standards. Effective March 20, 2008, the Company entered into a Lease Termination Agreement associated with conveyance of certain assets at Kinston to DuPont. This agreement terminated the Ground Lease and relieved the Company of any future responsibility for environmental remediation, other than participation with DuPont, if so called upon, with regard to the Company's period of operation of the Kinston site which was from 2004 to 2008. However, the Company continues to own a satellite service facility acquired in the INVISTA transaction that has contamination from DuPont's operations and is monitored by DENR. This site has been remediated by DuPont, and DuPont has received authority from DENR to discontinue remediation, other than natural attenuation. DuPont's duty to monitor and report to DENR will be transferred to the Company in the future, at which time DuPont must pay the Company for seven years of monitoring and reporting costs and the Company will assume responsibility for any future remediation and monitoring of the site. At this time, the Company has no basis to determine if or when it will have any responsibility or obligation with respect to the AOCs or the extent of any potential liability for the same.

Operating Leases

The Company routinely leases sales and administrative office space, warehousing and distribution centers, transportation equipment, manufacturing equipment, and other information technology and office equipment from third parties. In addition, Renewables leases farm land for use in growing a patented bio-energy crop, FREEDOM® Giant Miscanthus. The Company does not sub-lease any of its leased property.

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

23. Related Party Transactions

Related party receivables consist of the following:

	March 30, 2014	June 30, 2013
Cupron, Inc.	$ 17	$ 6
Dillon Yarn Corporation	—	198
Total related party receivables (included within receivables, net)	$ 17	$ 204

Related party payables consist of the following:

	March 30, 2014	June 30, 2013
Dillon Yarn Corporation	$ 201	$ 135
Salem Leasing Corporation	317	267
Cupron, Inc.	571	218
American Drawtech Company, Inc.	—	17
Total related party payables (included within accounts payable)	$ 1,089	$ 637

Related party transactions consist of the following:

Affiliated Entity	Transaction Type	For the Three Months Ended March 30, 2014	March 24, 2013
Dillon Yarn Corporation	Yarn purchases	$ 955	$ 694
Dillon Yarn Corporation	Sales service agreement costs	—	79
Dillon Yarn Corporation	Sales	—	1

Salem Leasing Corporation	Transportation equipment costs	854	765
American Drawtech Company, Inc.	Sales	—	449
American Drawtech Company, Inc.	Yarn purchases	—	19
Cupron, Inc.	Sales	254	91

Affiliated Entity	Transaction Type	For the Nine Months Ended March 30, 2014	March 24, 2013
Dillon Yarn Corporation	Yarn purchases	$2,407	$1,963
Dillon Yarn Corporation	Sales service agreement costs	—	346
Dillon Yarn Corporation	Sales	1,235	7
Salem Leasing Corporation	Transportation equipment costs	2,680	2,295
American Drawtech Company, Inc.	Sales	—	683
American Drawtech Company, Inc.	Yarn purchases	—	56
Cupron, Inc.	Sales	411	106
Cupron, Inc.	Yarn purchases	8	—

Pursuant to the 2013 SRP, the Company has repurchased 1,466 shares of its common stock through open market purchases, of which 898 shares were repurchased during the first nine months of fiscal year 2014. Invemed Associates LLC ("Invemed") provided brokerage services to the Company for the repurchase of these shares. The Company paid a commission of $.02 per share to Invemed. Mr. Kenneth G. Langone, a member of the Company's Board, is the founder and chairman of Invemed.

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

On November 1, 2013, the Company purchased 150 shares of the Company's common stock from Dillon, at a negotiated price of $23.00 per share, for $3,450. The purchase price was equal to an approximately 6% discount to the closing price of the common stock on October 31, 2013. Mr. Mitchel Weinberger, a member of the Company's Board, is Dillon's president and chief operating officer.

On December 3, 2013, certain of the Company's executive officers exercised options to purchase shares of the Company's common stock under previously granted option awards. Pursuant to authorization from the Company's Board, and as part of the 2013 SRP, the Company repurchased 225 shares of common stock issued in those option exercises at a negotiated price of $25.59 per share (which was equal to the average of the closing trade prices of the Company's common stock for the 30 days ending December 2, 2013 and represents a 7.1% discount to the $27.56 closing price of the common stock on December 2, 2013).

For a further discussion of the nature of certain related party relationships, see "Note 26. Related Party Transactions" included in the 2013 Form 10-K.

24. Business Segment Information

The Company has three operating segments, which are also its reportable segments. These segments derive revenues as follows:

The Polyester Segment manufactures Chip, POY, textured, dyed, twisted, beamed and draw wound yarns, both virgin and recycled, with sales primarily to other yarn manufacturers and knitters and weavers that produce yarn and/or fabric for the apparel, hosiery, automotive upholstery, home furnishings, industrial and other end-use markets. The Polyester Segment consists of sales and manufacturing operations in the U.S. and El Salvador.

The Nylon Segment manufactures textured nylon and covered spandex yarns, with sales to knitters and weavers that produce fabric for the apparel, hosiery, sock and other end-use markets. The Nylon Segment consists of sales and manufacturing operations in the U.S. and Colombia.

The International Segment’s products primarily include textured polyester and various types of resale yarns and staple fiber. The International Segment sells its yarns to knitters and weavers that produce fabric for the apparel, automotive upholstery, home furnishings, industrial and other end-use markets primarily in the South American and Asian regions. This segment includes manufacturing locations and sales offices in Brazil and a sales office in China.

The Company evaluates the operating performance of its segments based upon Segment Adjusted Profit, which is defined as segment gross profit plus segment depreciation and amortization less segment selling, general and administrative (“SG&A”) expenses and plus segment other adjustments. Segment operating profit represents segment net sales less cost of sales, restructuring and other charges and SG&A expenses. The accounting policies for the segments are consistent with the Company’s accounting policies. Intersegment sales are accounted for at current market prices.

Selected financial information for the Polyester, Nylon and International Segments is presented below:

	For the Three Months Ended March 30, 2014			
	Polyester	**Nylon**	**International**	**Total**
Net sales	$103,941	$39,208	$ 33,715	$176,864
Cost of sales	92,928	34,168	30,009	157,105
Gross profit	11,013	5,040	3,706	19,759
Selling, general and administrative expenses	7,781	2,540	1,969	12,290
Other operating expense	7	155	—	162
Segment operating profit	$3,225	$2,345	$ 1,737	$7,307

	For the Three Months Ended March 24, 2013			
	Polyester	**Nylon**	**International**	**Total**
Net sales	$96,389	$38,007	$ 33,853	$168,249
Cost of sales	91,355	34,326	29,887	155,568
Gross profit	5,034	3,681	3,966	12,681
Selling, general and administrative expenses	6,793	2,297	2,172	11,262
Segment operating (loss) profit	$(1,759)	$1,384	$ 1,794	$1,419

Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

The reconciliations of segment operating profit (loss) to consolidated income before income taxes are as follows:

	For the Three Months Ended	
	March 30, 2014	March 24, 2013
Polyester	$3,225	$(1,759)
Nylon	2,345	1,384
International	1,737	1,794
Segment operating profit	7,307	1,419
Provision for bad debts	137	74
Other operating expense, net	1,077	616
Operating income	6,093	729
Interest income	(214)	(240)
Interest expense	962	1,236
Loss on extinguishment of debt	—	746
Other non-operating expense	—	96
Equity in earnings of unconsolidated affiliates	(3,585)	(4,783)
Income before income taxes	$8,930	$3,674

Selected financial information for the Polyester, Nylon and International Segments is presented below:

	For the Nine Months Ended March 30, 2014			
	Polyester	Nylon	International	Total
Net sales	$286,933	$118,723	$ 100,494	$506,150
Cost of sales	255,763	104,230	87,916	447,909
Gross profit	31,170	14,493	12,578	58,241
Selling, general and administrative expenses	20,884	6,974	6,037	33,895
Other operating expense	356	155	—	511
Segment operating profit	$9,930	$7,364	$ 6,541	$23,835

	For the Nine Months Ended March 24, 2013			
	Polyester	Nylon	International	Total
Net sales	$286,747	$117,561	$ 108,912	$513,220
Cost of sales	265,069	105,794	94,965	465,828

Gross profit	21,678	11,767	13,947	47,392
Selling, general and administrative expenses	20,721	7,099	6,121	33,941
Segment operating profit	$957	$4,668	$ 7,826	$13,451

The reconciliations of segment operating profit to consolidated income before income taxes are as follows:

	For the Nine Months Ended	
	March 30, 2014	**March 24, 2013**
Polyester	$9,930	$957
Nylon	7,364	4,668
International	6,541	7,826
Segment operating profit	23,835	13,451
Provision for bad debts	186	257
Other operating expense, net	3,497	1,777
Operating income	20,152	11,417
Interest income	(1,570)	(508)
Interest expense	3,117	4,041
Loss on extinguishment of debt	—	1,102
Other non-operating expense	—	96
Equity in earnings of unconsolidated affiliates	(14,830)	(6,712)
Income before income taxes	$33,435	$13,398

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Unifi, Inc.

Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

The reconciliations of segment depreciation and amortization expense to consolidated depreciation and amortization expense are as follows:

	For the Three Months Ended		**For the Nine Months Ended**	
	March 30, 2014	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Polyester	$3,109	$4,449	$8,680	$13,827
Nylon	510	745	1,775	2,258
International	854	860	2,271	2,546
Segment depreciation and amortization expense	4,473	6,054	12,726	18,631
Depreciation and amortization included in other operating expense, net	87	55	247	146
Amortization included in interest expense	105	157	317	486
Depreciation and amortization expense	$4,665	$6,266	$13,290	$19,263

Segment other adjustments for each of the reportable segments consist of the following:

	For the Three Months Ended		**For the Nine Months Ended**	
	March 30, 2014	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Polyester	$172	$ 263	$365	$ 357
Nylon	—	87	(157)	87
International	98	—	352	56
Segment other adjustments	$270	$ 350	$560	$ 500

Segment other adjustments may include items such as severance charges, restructuring charges and recoveries, start-up costs, and other adjustments necessary to understand and compare the underlying results of the segment.

Segment Adjusted Profit for each of the reportable segments consists of the following:

	For the Three Months Ended		For the Nine Months Ended	
	March 30, 2014	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Polyester	$6,513	$2,953	$19,331	$15,141
Nylon	3,010	2,216	9,137	7,013
International	2,689	2,654	9,164	10,428
Segment Adjusted Profit	$12,212	$7,823	$37,632	$32,582

Intersegment sales for each of the reportable segments consist of the following:

	For the Three Months Ended		For the Nine Months Ended	
	March 30, 2014	**March 24, 2013**	**March 30, 2014**	**March 24, 2013**
Polyester	$132	$ 62	$224	$1,031
Nylon	68	249	204	423
International	563	373	1,077	772
Intersegment sales	$763	$ 684	$1,505	$2,226

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Notes to Condensed Consolidated Financial Statements – (Continued)

(amounts in thousands, except per share amounts)

The reconciliations of segment capital expenditures to consolidated capital expenditures are as follows:

	For the Three Months Ended		For the Nine Months Ended	
	March 30, 2014	March 24, 2013	March 30, 2014	March 24, 2013
Polyester	$3,008	$641	$10,041	$2,559
Nylon	423	82	1,850	252
International	179	345	1,062	634
Segment capital expenditures	3,610	1,068	12,953	3,445
Unallocated corporate capital expenditures	349	582	437	1,077
Capital expenditures	$3,959	$1,650	$13,390	$4,522

The reconciliations of segment total assets to consolidated total assets are as follows:

	March 30, 2014	June 30, 2013
Polyester	$189,320	$185,190
Nylon	73,501	72,599
International	79,579	84,151
Segment total assets	342,400	341,940
All other current assets	2,710	3,342
Unallocated corporate PP&E	12,461	11,983
All other non-current assets	4,638	4,940
Investments in unconsolidated affiliates	98,430	93,261
Total assets	$460,639	$455,466

Geographic Data:

Geographic information for net sales is as follows:

For the Three Months Ended		For the Nine Months Ended	
March 30, 2014	March 24, 2013	March 30, 2014	March 24, 2013

U.S.	$132,431	$123,895	$377,394	$372,684
Brazil	28,328	28,357	84,792	89,284
All Other Foreign	16,105	15,997	43,964	51,252
Total	$176,864	$168,249	$506,150	$513,220

The information for net sales is based on the operating locations from where the items were produced or distributed. Export sales from the Company's U.S. operations to external customers were $24,027 and $20,895 for the three months ended March 30, 2014 and March 24, 2013, respectively. Export sales from the Company's U.S. operations to external customers were $73,982 and $66,459 for the nine months ended March 30, 2014 and March 24, 2013, respectively.

Geographic information for long-lived assets is as follows:

	March 30, 2014	**June 30, 2013**
U.S.	$209,496	$200,958
Brazil	12,063	16,150
All Other Foreign	7,954	8,658
Total	$229,513	$225,766

Long-lived assets are comprised of property, plant and equipment, net, intangible assets, net, investments in unconsolidated affiliates and other non-current assets, excluding other investments.

Geographic information for total assets is as follows:

March 30, 2014