Rodman & Renshaw

SmartHeat Inc (HEAT)

EARNINGS UPDATE

CHINA

Joe Giamichael
212-920-3593
jgiamichael@rodm.com
Dmitriy Shapiro
212-430-1767
ds@rodm.com

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Market Outperform / Speculative Risk

Q2 Results Ahead of Estimates, Increasing FY EPS, Raising Price Target to $13

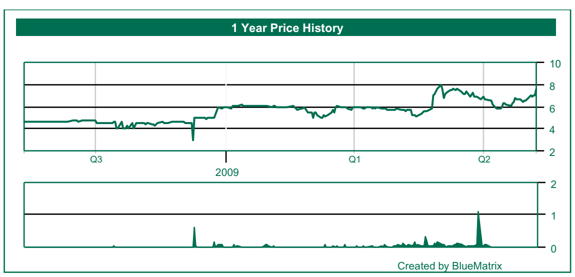
MARKET DATA	Intraday - 8/11/2009
Price	$9.25
Market	NASDAQ
Target Price	$13.00
52 Wk Hi - Low	$9.91 - $2.25
EV(MM)	$214.5
Market Cap(MM)	$223.7
Shares Out (MM)	24.9
Public Mkt Float (MM)	89.8
Avg. Daily Vol (000)	34.9

BALANCE SHEET METRICS	
Cash (MM)	$2.4
LTD (MM)	$0.0
Total Debt/Total Equity	29.40%
Debt/Capital	22.7%
Price/Book Value	$10.5
Book Value/Share	$0.89

EARNINGS DATA ($)			
FY - Dec	**2008A**	**2009E**	**2010E**
Q1 (Mar)	0.03	0.05	--
Q2 (Jun)	0.03	0.11	--
Q3 (Sep)	0.18	0.28*E*	--
Q4 (Dec)	0.03	0.20*E*	--
Full Year EPS	0.29	0.64*E*	0.93*E*

VALUATION METRICS			
Price/Earnings	31.9x	14.5x	9.9x
Long Term EPS Growth	1.6%	1.2%	0.5%

INDICES	
DJIA	9,242.6
SP-500	993.9
NASDAQ	1,964.9
Russel 2000	560.7



SmartHeat reported strong top and bottom line results, beating our estimates, and raised its previous guidance for the full year 2009. Revenues for the quarter grew ~125% Y/Y to $12.5mm, well ahead of our $8.1mm estimate. Management cited significant market share expansion in a favorable market environment for energy savings industry as the reason for the strong growth. It should be noted that we had modeled in the traditional seasonal effect with an overallocation of full year revenue to Q3. Current results and subsequent guidance have shown that seasonal patterns are smoothing out as the business scales. The Company benefited significantly from the implementation of China's economic stimulus plan and SmartHeat saw strong growth in all of its product lines and expects to continue to deliver strong earnings growth in the future. Gross profit margin for the quarter expanded over 1000bps to 36.2% from 26% a year ago, primarily due to greater percentage of higher margin PHE Units being sold. Gross profit in terms of dollars increased by 213% to $4.5mm, above our estimate of $2.7mm.

Operating income increased by over 250% Y/Y to $3.1mm in Q2, relative to our expectations of $1.4mm. This translates to operating margins of 24.4%, representing an 880bps Y/Y improvement. Q2 results reflected a combination of efficient cost management, increased economies of scale due to rapid growth in revenue, as well as improved operating efficiency. Net income came in at $2.6mm, or $0.11 per fully diluted share, above our estimate of $0.05, and represented a 224% Y/Y bottom line growth. This corresponded to a 20.9% net margin, a ~775bps improvement from the same quarter last year. EBITDA for the quarter came in at $3.2mm, representing a 242% Y/Y growth and a 25.2% margin, compared to a 16.6% margin showed in Q2 FY08.

Positive Outlook, Management Raises Guidance

Management of the Company expressed its view that growth momentum will continue throughout 2009 and well into 2010. The demand environment for SmartHeat's plate heat exchange related products stands to benefit significantly from Chinese environmental policy changes, as well as the $580bil economic stimulus plan. The implementation of the stimulus plan should continue to re-inflate the residential and commercial new construction market as well as support the creation of new nuclear plant facilities. Additionally, the recently completed acquisition of Siping Heat Exchanger Manufacturer, one of China's largest PHE manufacturers, has not only expanded HEAT's production capabilities but also extended its product offerings to new customer segments. SmartHeat's management believes that the current economic slowdown has significantly increased customer awareness towards utilization of energy savings equipment, of which HEAT is the primary beneficiary. Finally, management has indicated that they are seeing positive signs of economic recovery in the 2H09, with much greater customer order flow compared to the first half 2009.

Raising Estimates and Price Target

Please see page 2 for full valuation.

In light of these events, management raised its previous guidance for FY09 and provided specific guidance for the upcoming quarter. For the third quarter, historically the strongest seasonal quarter for SmartHeat, the Company expects to earn $6.8mm in net income on revenues of $35mm, which corresponds to 57% and 69% Y/Y growth, respectively. The Company expects to report revenues of $80mm for the full year, a 145% Y/Y growth, and net income of $15.5mm, a 19.5% Y/Y growth. This is an increase from previous guidance levels of $79mm in revenues and $15mm in net income for the full year.

Strong Balance Sheet
SmartHeat finished the quarter with $2.4mm in cash and $6.3mm in total debt, which comes out to a net debt position of only $3.9mm. As of June 30, 2009, HEAT had a total debt to book value of equity of 29.4% and a net debt to total capital of only 14.1%. Furthermore, the Company had a current ratio of 1.6x, acid-test ratio of 1.1x and an interest coverage ratio of ~39x. These metrics demonstrate that the Company does not represent either short-term liquidity or long-term solvency risk in its current operating form.

Recent S3 Filing Approved by SEC
SmartHeat had previously filed an S3 (shelf offering) which was subject to an SEC review. This S3 would authorize the company to offer up to $75mm of new shares to investors through an equity transaction; which was approved this past week. As a company with significant growth prospects over the next several years, we would anticipate the company raising equity capital to fund the expansionary needs, both in working capital, capex as well as potential acquisitions.

We remind investors that management agreed to a 3 year lockup of all of their ownership (~40% of the total outstanding shares) on January 29th of 2009. This has aligned their interests with creating long term value in the company and indicates to us that they will be cautious stewards of capital, building the business organically and seeking only strategic and accretive transactions as a means to scale into a larger, sustainable entity.

Raising Estimates and Price Target
In light of solid Q2 results and continued upbeat management commentary, as well as to reflect increased traction in the petrochemical, retrofit and new construction markets, we have chosen to raise our estimates. We have raised our FY09 revenue estimate to $80mm and our net income to $15.5mm, or $0.64 per fully diluted share, from our previous revenue and EPS estimates of $75.7mm and $0.61, respectively. We have also raised our FY10 revenue estimate from $100mm to $113mm and our respective EPS estimate from $0.81 to $0.93.

We have chosen to reiterate our Market Outperform rating and raise our twelve to eighteen months Price Target from $10 to $13. In our opinion, SmarHeat continues to be an exciting growth story, focused on two central themes that have significant Chinese governmental support both from a legislative and financial standpoint, energy efficiency and pollution reduction. At $13.00 per share, the stock would be trading at 20.5x FY 09 and 14x FY 10 on a P/E basis, compared to the peer group's respective estimates of 19.8x and 16.9x. In our opinion a target price of $13 is easily justified by SmartHeat's profitability and significant potential growth opportunities. HEAT's 2008 – 2011 CAGR is over 50%, based on our revised estimates, and should come from organic growth as well as other potential strategic acquisitions. This translates to a PEG ratio of 0.9 using a $13 price target, which indicates that the stock is still cheap even at these levels, both on an absolute basis and compared to the group's average. Please see Table 1 below for the full peer group valuation analysis.

Table 1: Peer Group Valuation

Name	Ticker	Rating	Price	Market Value	EV	Net Debt/Total Cap	P/E 2008	P/E 2009	P/E 2010	Growth '08 - '11	PEG
IDEX CORP	IEX	Not Rated	$27.17	$2,192.4	$2,632.4	16.3%	13.7	19.5	17.0	-4.6%	NA
GRACO INC	GGG	Not Rated	$24.77	$1,484.3	$1,629.0	8.8%	12.4	35.3	21.6	-10.0%	NA
COLFAX CORP	CFX	Not Rated	$11.32	$489.4	$550.5	10.5%	9.3	12.1	14.9	-16.9%	NA
SUNOCO INC	SUN	Not Rated	$25.65	$2,997.9	$5,290.9	42.8%	3.4	15.1	8.0	-11.6%	NA
LENNOX INTERNATIONAL INC	LII	Not Rated	$34.44	$1,922.1	$2,142.9	9.8%	12.7	21.0	16.9	-4.9%	NA
EMCOR GROUP INC	EME	Not Rated	$24.24	$1,597.0	$1,272.6	-18.1%	8.5	11.3	13.2	-9.7%	NA
COMFORT SYSTEMS USA INC	FIX	Not Rated	$12.06	$462.4	$351.0	-23.6%	9.7	14.6	18.6	-8.5%	NA
WATSCO INC	WSO	Not Rated	$51.71	$1,476.4	$1,451.3	-1.7%	23.7	36.9	24.6	9.1%	2.6
GRAINGER (W W) INC	GWW	Not Rated	$88.05	$6,482.5	$6,601.2	1.7%	14.6	17.6	15.9	1.4%	10.6
WATERFURNACE RENEWABL	WFI-CA	Not Rated	$23.26	$281.3	$268.6	-4.5%	14.8	19.6	16.2	NA	NA
ROBBINS & MYERS INC	RBN	Not Rated	$22.40	$735.6	$677.6	-7.6%	10.3	15.3	18.8	-9.8%	NA
AVERAGE				**$1,829.2**	**$2,078.9**	**3.1%**	**12.1**	**19.8**	**16.9**	**-6.6%**	**6.6**
SMARTHEAT INC	HEAT	Outperform	$9.32	$225.6	$229.5	1.7%	32.6	14.7	10.0	52.7%	0.6
Multiples with Price Target			**$13.00**	**314.4**	**318.3**		**45.5**	**20.5**	**14.0**	**52.7%**	**0.9**

Income Statement All Figures $MM, except per share	FY 2006a	FY 2007a	Q1 3/08a	Q2 6/08a	Q3 9/08a	Q4 12/08a	FY 2008a	Q1 3/09a	Q2 6/09a	Q3 9/09	Q4 12/09	FY 2009	Q1 3/10	Q2 6/10	Q3 9/10	Q4 12/10	FY 2010
Net Sales	**8.2**	**13.3**	**3.1**	**5.6**	**20.7**	**3.3**	**32.7**	**6.2**	**12.5**	**35.8**	**25.5**	**80.0**	**8.4**	**17.2**	**52.7**	**34.9**	**113.3**
% growth year-to-year		62%	137%	379.5%	586.7%	-57.3%	146.2%	102%	124.9%	72.7%	664.9%	144.7%	35.8%	37.6%	47.5%	37.0%	41.7%
Cost of Goods Sold	5.7	8.7	2.1	4.1	13.3	2.2	21.7	3.9	8.0	24.0	16.8	52.7	5.5	11.4	34.3	22.9	74.1
% of Revenue	69.6%	65.3%	68.6%	74.0%	64.1%	66.5%	66.5%	62.8%	63.8%	67.0%	66.0%	65.9%	65.5%	66.0%	65.0%	65.7%	65.4%
% growth year-to-year		-88.6%	150.8%	444.1%	537.9%	-55.6%	150.6%	84.6%	93.8%	80.5%	658.9%	142.4%	41.5%	42.4%	43.1%	36.4%	40.7%
Gross Profit	**2.5**	**4.6**	**1.0**	**1.4**	**7.4**	**1.1**	**11.0**	**2.3**	**4.5**	**11.8**	**8.7**	**27.3**	**2.9**	**5.8**	**18.5**	**12.0**	**39.2**
% of Revenue	30.4%	34.7%	31.4%	26.0%	35.9%	33.5%	33.5%	37.2%	36.2%	33.0%	34.0%	34.1%	34.5%	34.0%	35.0%	34.3%	34.6%
% growth year-to-year		NA	111.7%	258.3%	695.2%	-60.4%	137.9%	138.8%	213.5%	58.8%	676.9%	149.1%	26.1%	29.3%	56.4%	38.2%	43.6%
Selling expenses	1.2	1.7	0.2	0.4	1.1	(0.1)	1.6	0.5	0.7	2.2	1.4	4.8	0.5	1.0	3.0	2.0	6.5
% of Revenue	14.4%	12.7%	6.4%	7.4%	5.1%	-3.0%	4.8%	7.4%	5.6%	6.2%	5.5%	6.0%	5.9%	5.8%	5.7%	5.7%	5.7%
% growth year-to-year		42.4%	-9.1%	53.4%	230.1%	-111.4%	-6.9%	133.5%	70.1%	108.2%	-1501.3%	204.1%	8.5%	43.1%	36.4%	42.9%	36.6%
General and adminstrative expenses	0.5	0.7	0.3	0.2	1.0	0.4	1.9	0.6	0.8	1.4	1.2	3.9	0.8	1.0	1.8	1.4	5.0
% of Revenue	5.6%	5.2%	9.2%	2.9%	4.9%	11.4%	5.7%	9.2%	6.2%	3.9%	4.7%	4.9%	9.5%	5.8%	3.4%	4.0%	4.4%
% growth year-to-year		49.0%	80.5%	14.8%	346.5%	139.3%	169.4%	100.4%	374.7%	36.7%	214.9%	112.8%	40.5%	29.8%	28.6%	16.7%	26.9%
Operating Income	**0.9**	**2.2**	**0.5**	**0.9**	**5.4**	**0.8**	**7.5**	**1.3**	**3.1**	**8.2**	**6.1**	**18.6**	**1.6**	**3.8**	**13.7**	**8.6**	**27.7**
% of Revenue	10.4%	16.9%	15.7%	15.7%	25.9%	25.0%	23.1%	20.6%	24.4%	22.9%	23.8%	23.3%	19.1%	22.4%	25.9%	24.6%	24.4%
% growth year-to-year		162.6%	492.4%	-13804.5%	1289.4%	-53.1%	237.2%	163.4%	251.1%	53.2%	627.1%	146.6%	26.0%	26.0%	66.5%	41.4%	48.9%
Interest Income	0.10	0.2	0.1	0.1	0.1	0.1	0.4	0.0	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.4
% of Revenue	1.2%	1.3%	4.8%	2.0%	0.3%	2.6%	1.2%	0.3%	0.5%		0.3%	0.3%	1.0%	0.5%	0.2%	0.3%	0.3%
% growth year-to-year			113.2%	19.0%	NA	717.7%	131.5%	NA	-43.9%	22.2%	-11.5%	-43.8%					
Interest Expenses	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.3)	(0.1)	(0.1)	(0.3)	(0.3)	(0.7)	(0.2)	(0.2)	(0.2)	(0.2)	(0.8)
% of Revenue	-0.99%	-1.7%	-2.2%	-1.7%	-0.5%	-1.7%	-1.0%	-0.9%	-0.5%	-0.8%	-1.1%	-0.9%	-2.4%	-1.2%	-0.4%	-0.6%	-0.7%
% growth year-to-year			NA	66.6%	NA	NA	36.1%	NA	-32.8%	208.0%	407.7%	121.9%	278.4%	208.8%	-31.0%	-31.0%	14.8%
Total non-Operating Expenses	**0.0**	**0.0**	**0.1**	**0.0**	**(0.0)**	**0.0**	**0.1**	**(0.0)**	**0.0**	**(0.2)**	**(0.2)**	**(0.4)**	**(0.1)**	**(0.1)**	**(0.1)**	**(0.1)**	**(0.4)**
% of Revenue	0.5%	0.3%	3.2%	0.4%	-0.2%	0.4%	0.3%	-0.6%	0.2%	-0.6%	-0.8%	-0.6%	-1.4%	-0.6%	-0.2%	-0.2%	-0.4%
% growth year-to-year		NA	-13.6%	-52.0%	-62.8%	-196.4%	164.9%	-138.0%	7.6%	424.1%	NA	-576.3%	209.2%	-523.8%	-55.7%	-59.0%	-8.6%
Income Before Taxes	**0.9**	**2.3**	**0.6**	**0.9**	**5.3**	**0.8**	**7.6**	**1.24**	**3.1**	**8.0**	**5.8**	**18.2**	**1.5**	**3.7**	**13.6**	**8.5**	**27.3**
% of Revenue	10.9%	17.1%	18.9%	16.1%	25.6%	25.4%	23.4%	20.0%	24.6%	22.3%	23.0%	22.7%	17.7%	21.8%	25.7%	24.3%	24.1%
% growth year-to-year		154.8%	198.4%	2007.9%	1847.1%	-51.9%	236.1%	112.7%	244.8%	50.3%	590.2%	137.8%	20.5%	21.5%	69.9%	45%	50.3%
Income Tax Expense	0.1	0.2	0.1	0.2	1.0	0.0	1.3	0.2	0.5	1.2	0.9	2.8	0.2	0.6	2.0	1.3	4.1
Tax Rate %	8.14%	7.7%	18.0%	18.0%	18.5%	5.5%	16.9%	17.6%	15.0%	15.0%	15.0%	15.2%	15.0%	15.0%	15.0%	15.0%	15.0%
Minority Interest	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
% of Revenue	-100%	0.0%	NA	0.0%	0.1%	0.0%	0.0%					0.0%					0.0%
% growth year-to-year							NA										
Net Income	**0.8**	**2.1**	**0.5**	**0.7**	**4.3**	**0.8**	**6.3**	**1.1**	**2.6**	**6.8**	**5.0**	**15.5**	**1.3**	**3.2**	**11.5**	**7.2**	**23.2**
% of Revenue	10.1%	15.8%	15.5%	13.2%	20.9%	24.0%	19.4%	17.9%	20.9%	19.0%	19.5%	19.4%	15.1%	18.5%	21.9%	20.7%	20.5%
% growth year-to-year		152.0%	144.6%	22780.7%	1865.5%	-52.3%	201.9%	132.9%	257.4%	56.9%	520.9%	144.5%	14.1%	21.5%	69.9%	45.1%	49.7%
Proforma EPS	**0.05**	**0.11**	**0.03**	**0.03**	**0.18**	**0.03**	**0.29**	**0.05**	**0.11**	**0.28**	**0.20**	**0.64**	**0.05**	**0.13**	**0.46**	**0.29**	**0.93**
% growth year-to-year		152.0%	144.6%	19204.8%	1411.5%	-63.6%	151.9%	78.1%	223.7%	54.2%	511.2%	122.5%	11.6%	18.3%	66.5%	42.2%	46.0%
Weighted Avg. S/O (mil)-fd	18.5	18.5	18.5	21.9	24.1	24.2	22.2	24.2	24.2	24.5	24.6	24.4	24.7	24.9	25.0	25.1	24.9
EBITDA	**0.9**	**2.3**	**0.5**	**0.9**	**5.4**	**0.9**	**7.8**	**1.4**	**3.2**	**8.3**	**6.2**	**19.0**	**1.7**	**3.9**	**13.8**	**8.7**	**28.1**
% of Revenue	11.2%	17.0%	17.4%	16.6%	26.2%	27.4%	23.9%	22.1%	25.2%	23.2%	24.2%	23.7%	20.2%	22.9%	26.1%	24.8%	24.8%
% growth year-to-year		145.7%	427.1%	6655.0%	1088.8%	-49.0%	245.0%	155.9%	241.9%	53.1%	575.0%	143.6%	24.2%	25.2%	65.7%	40.8%	47.9%
Depreciation & Amortization	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.4	0.1	0.1	0.1	0.1	0.4
% of Revenue	0.8%	0.8%	1.7%	0.9%	0.3%	2.4%	0.8%	1.6%	0.8%	0.3%	0.4%	0.5%	1.2%	0.6%	0.2%	0.3%	0.3%
% growth year-to-year		53.9%	160.1%	160.1%	-1.6%	498.3%	142.8%	85.9%	87.1%	39.5%	23.6%	53.9%	0.7%	0.0%	0.0%	0.0%	0.2%

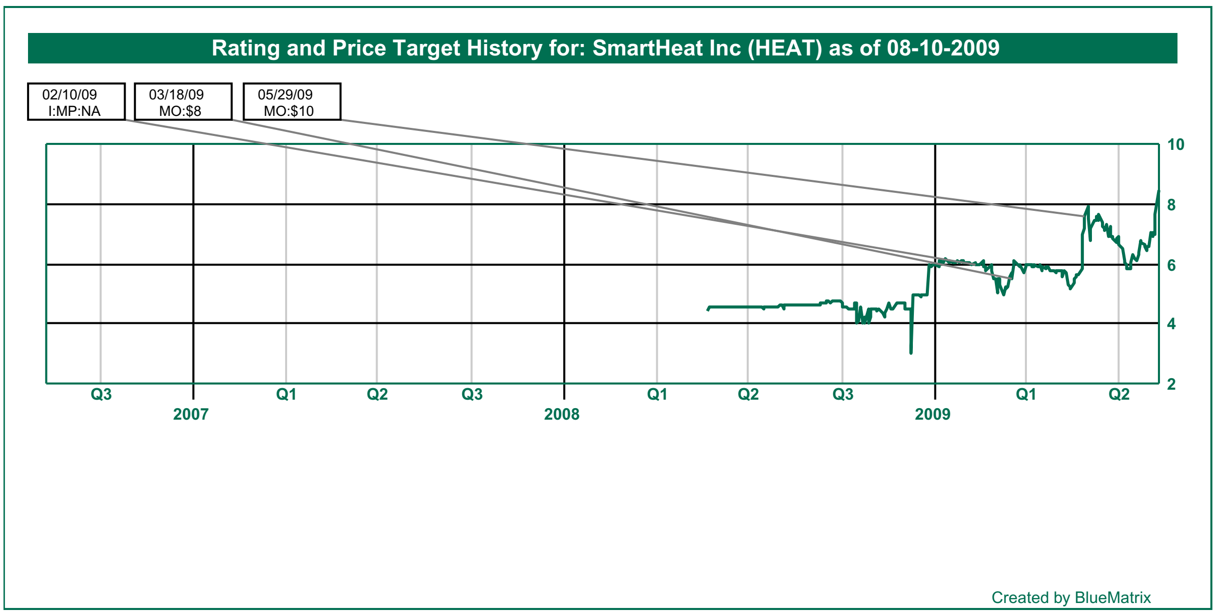
RODMAN & RENSHAW RATING SYSTEM: Rodman & Renshaw employs a three tier rating system for evaluating both the potential return and risk associated with owning common equity shares of rated firms. The expected return of any given equity is measured on a RELATIVE basis of other companies in the same sector, as defined by First Call. The price objective is calculated to estimate the potential movement in price a given equity could achieve given certain targets are met over a defined time horizon. Price objectives are subject to exogenous factors including industry events and market volatility. The risk assessment evaluates the company specific risk and accounts for the following factors, maturity of market, maturity of technology, maturity of firm, cash utilization, and valuation considerations. Potential factors contributing to risk: relatively undefined market, new technologies, immature firm, high cash burn rates, intrinsic value weighted toward future earnings or events.

RETURN ASSESSMENT

- Market Outperform (Buy): The common stock of the company is expected to outperform a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
- Market Perform (Hold): The common stock of the company is expected to mimic the performance of a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
- Market Underperform (Sell): The common stock of the company is expected to underperform a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.

RISK ASSESSMENT

- Speculative - The common stock risk level is significantly greater than market risk. The stock price of these equities is exceptionally volatile.
- Aggressive - The common stock risk level is materially higher than market level risk. The stock price is typically more volatile than the general market.
- Moderate - The common stock is moderately risky, or equivalent to stock market risk. The stock price volatility is typically in-line with movements in the general market.



RATING SUMMARY

Distribution of Ratings Table

			IB Serv./Past 12 Mos	
Rating	Count	Percent	Count	Percent
Market Outperform(MO)	76	70.40%	13	17.11%
Market Perform(MP)	24	22.20%	5	20.83%
Market Underperform(MU)	1	0.90%	0	0.00%
Under Review(UR)	7	6.50%	2	28.57%
Total	108	100%	20	100%

Investment Banking Services include, but are not limited to, acting as a manager/co-manager in the underwriting or placement of securities, acting as financial advisor, and/or providing corporate finance or capital markets-related services to a company or one of its affiliates or subsidiaries within the past 12 months.

ADDITIONAL DISCLOSURES

Rodman & Renshaw, LLC. (the "Firm") is a member of FINRA and SIPC and a registered U.S. Broker-Dealer.

ANALYST CERTIFICATION

I, Joe Giamichael, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities.

None of the research analysts or the research analyst's household has a financial interest in the securities of SmartHeat Inc (including, without limitation, any option, right, warrant, future, long or short position).

As of Jun 30 2009 neither the Firm nor its affiliates beneficially own 1% or more of any class of common equity securities of SmartHeat Inc.

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