

Hollysys Automation Technologies, Ltd.
Form 20-F
September 21, 2011

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

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report _____

Commission file number: 001-33602

HOLLYSYS AUTOMATION TECHNOLOGIES LTD.
(Exact name of Registrant as specified in its charter)

Not Applicable
(Translation of Registrant's name into English)

British Virgin Islands
(Jurisdiction of incorporation or organization)

No. 2 Disheng Middle Road,
Beijing Economic-Technological Development Area,
Beijing, P. R. China 100176
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

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Title of each class	Name of each exchange on which registered
Ordinary Shares	The NASDAQ Global Select Market

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or ordinary shares as of the close of the period covered by the annual report (June 30, 2011): [54,692,129] ordinary shares.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

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 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 No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

HOLLYSYS AUTOMATION TECHNOLOGIES LTD.

ANNUAL REPORT ON FORM 20-F
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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USE OF CERTAIN DEFINED TERMS

Except as otherwise indicated by the context, references in this annual report to:

- “Beijing Haotong” are references to Beijing Haotong Science and Technology Development Co., Ltd.;
 - “Beijing Helitong” are references Beijing Helitong S&T Exploration Co., Ltd.;
 - “Beijing Hollycon” are references to Beijing Hollycon Med. & Tech. Co., Ltd.;
 - “Beijing Hollysys” are references to Beijing Hollysys Co., Ltd.;
- “Beijing Hollysys Electronics” are references to Beijing Hollysys Electronics Technology Co., Ltd.;
- “Beijing Hollysys S&T” are references to Beijing Hollysys S&T Exploration Co., Ltd.;
- “Beijing WoDeWeiye” are references to Beijing WoDeWeiye Technology Exploration Co., Ltd.;
 - “BVI” are references to the British Virgin Islands;
- “China” and “PRC” are references to the People’s Republic of China and references to “Hong Kong” are references to the Hong Kong Special Administrative Region of China;
 - “Clear Mind” are references to Clear Mind Limited, a BVI company;
- “Concord” are references to a Singapore Group, including Concord Corporation Pte. Ltd., and Concord Electrical Pte. Ltd., and their subsidiaries Concord Electrical Sdn. Bhd. and Concord Corporation Pte. Ltd, Dubai Branch;
 - “Exchange Act” are references to the Securities Exchange Act of 1934, as amended;
 - “Gifted Time” are references to Gifted Time Holdings Limited, a BVI company;
 - “Hangzhou Hollysys” are references to Hangzhou Hollysys Automation Co., Ltd.;
- “Hollysys” “we,” “us,” or “our,” and the “Company,” are references to the combined business of Hollysys Automation Technologies Ltd., a BVI company, and its consolidated subsidiaries, Singapore Hollysys, Gifted Time, Clear Mind, World Hope, Beijing Helitong, Beijing Hollysys S&T, Hangzhou Hollysys, Hollysys Automation, Beijing Hollysys, Beijing Hollysys Electronics, Beijing Hollycon, Beijing Haotong, Beijing WoDeWeiye, Xi’an Hollysys and Hollysys Investments ;
 - “Hollysys Automation” are references to Beijing Hollysys Automation & Drive Co., Ltd.;
 - “HollysysInvestments” are references to Hollysys (Beijing) Investments Co., Ltd.;
- “RMB,” are references to Renminbi, the legal currency of China and “U.S. dollars,” “\$” and “US\$” are to the legal currency of the United States;
 - “Securities Act,” are references to the Securities Act of 1933, as amended;

- “Singapore Hollysys” are references to Hollysys (Asia Pacific) Pte. Limited, a Singapore company;
- “World Hope” are references to World Hope Enterprises Limited, a Hong Kong company; and
 - “Xi’an Hollysys” are references to Xi’an Hollysys Co., Ltd.

FORWARD-LOOKING INFORMATION

This annual report contains forward-looking statements and information relating to us that are based on the current beliefs, expectations, assumptions, estimates and projections of our management regarding our company and industry. When used in this annual report, the words “may”, “will”, “anticipate”, “believe”, “estimate”, “expect”, “intend”, “plan”, and similar expressions, as they relate to us or our management, are intended to identify forward-looking statements. These statements reflect management's current view of us concerning future events and are subject to certain risks, uncertainties and assumptions, including among many others: our potential inability to achieve similar growth in future periods as we did historically, a decrease in the availability of our raw materials, the emergence of additional competing technologies, changes in domestic and foreign laws, regulations and taxes, changes in economic conditions, uncertainties related to China’s legal system and economic, political and social events in China, the volatility of the securities markets, and other risks and uncertainties which are generally set forth under the heading, “Key information — Risk Factors” and elsewhere in this annual report. Should any of these risks or uncertainties materialize, or should the underlying assumptions about our business and the commercial markets in which we operate prove incorrect, actual results may vary materially from those described as anticipated, estimated or expected in this annual report.

All forward-looking statements included herein attributable to us or other parties or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable laws and regulations, we undertake no obligations to update these forward-looking statements to reflect events or circumstances after the date of this annual report or to reflect the occurrence of unanticipated events.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Consolidated Financial Data

The following table presents selected financial data regarding our business. It should be read in conjunction with our consolidated financial statements and related notes contained elsewhere in this annual report and the information under Item 5, "Operating and Financial Review and Prospects." The selected consolidated statement of operations data for the fiscal years ended June 30, 2009, 2010 and 2011 and the consolidated balance sheet data as of June 30, 2010 and 2011 have been derived from the audited consolidated financial statements of Hollysys that are included in this annual report beginning on page F-1. The selected statement of operations data for the fiscal years ended June 30, 2007 and 2008, and balance sheet data as of June 30, 2007, 2008 and 2009 have been derived from our audited financial statements that are not included in this annual report.

The audited consolidated financial statements for the years ended June 30, 2009, 2010 and 2011 are prepared and presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. The selected financial data information is only a summary and should be read in conjunction with the historical consolidated financial statements and related notes of Hollysys contained elsewhere herein. The financial statements contained elsewhere fully represent our financial condition and operations; however, they are not indicative of our future performance.

	Years Ended June 30,				
	2007	2008	2009	2010	2011
Statement of Operations Data					
Revenue	101,885,486	121,498,752	157,502,067	174,089,196	262,841,886
Operating income (loss)	25,711,773	5,844,538	(5,550,479)	32,547,400	44,690,766
Income before income taxes	18,646,368	2,248,419	(5,603,121)	35,219,424	47,909,081
Income (loss)(1) attributable to Hollsys	13,084,751	(1,677,178)	(13,851,064)	25,704,538	41,469,998
Add: Amortization of discount and interest on notes payable related to bridge loan	6,401,975	3,244,434	-	-	-
Stock-based compensation cost for incentive shares	-	17,000,000	39,240,000	-	95,338
Stock-based compensation cost for options	-	84,473	319,026	524,076	456,628
Non-GAAP net income attributable to Hollsys	19,486,726	18,651,729	25,707,962	26,228,614	42,021,964
Weighted average ordinary shares	22,200,000	37,658,437	44,950,883	51,243,667	54,564,842
Weighted average number of diluted ordinary shares	22,883,836	37,658,437	44,950,883	51,838,294	54,949,280
Basic earnings per share(1)	0.59	(0.04)	(0.31)	0.50	0.76
Diluted earnings per share(1)	0.57	(0.04)	(0.31)	0.50	0.75
Non-GAAP basic earnings per share	0.88	0.50	0.57	0.51	0.77
Non-GAAP diluted earnings per share	0.85	0.48	0.51	0.51	0.76
Cash dividends declared per share	0.03	-	-	-	-
Balance Sheet Data					
Total current assets	128,404,729	214,320,514	283,971,473	301,359,086	362,411,956
Total assets	154,930,570	252,734,095	345,443,522	384,730,251	458,583,944
Total current liabilities	101,419,000	71,028,772	101,121,574	135,917,248	161,038,804
Total liabilities	104,703,288	87,794,820	149,424,388	171,258,661	192,715,669
Non-controlling interest	13,200,169	17,645,377	22,479,241	774,865	810,618
Stockholders' equity	37,027,113	147,293,898	173,539,893	212,696,725	265,057,657

(1) We have no discontinued operations. Therefore net income and net income per share have been provided in lieu of income from continuing operations and income (loss) from continuing operations per share.

In evaluating our results, the non-GAAP measures of “Non-GAAP G&A Expenses”, “Non-GAAP Income (loss) from Operations”, and “Non-GAAP Net income (loss) and Earnings (loss) per share” serve as additional indicators of our operating performance and not as a replacement for other measures in accordance with U.S. GAAP. We believe these non-GAAP measures are useful to investors, as they exclude amortization of discount and interest on notes payable related to the bridge loan and stock-based compensation costs. The amortization of discount and interest on notes payable related to bridge loan is non-recurrent and non-operation-related in nature. The stock-based compensation is calculated based on the number of shares granted and the stock price as of the grant date. It will not result in any cash inflows or outflows. We believe that using non-GAAP measures help our shareholders to have a better understanding of our operating results and growth prospects. In addition, given the business nature of Hollsys, it has been a common practice for investors and analysts to use such non-GAAP measures to evaluate the Company.

The following table provides a reconciliation of U.S. GAAP measures to the non-GAAP measures for the periods indicated:

	Years ended June 30,				
	2007	2008	2009	2010	2011
G&A Expenses	7,135,221	26,588,771	48,981,078	13,914,091	16,671,448
Minus: Stock-based compensation cost for incentive shares	-	17,000,000	39,240,000	-	95,338
Minus: Stock-based compensation cost for options	-	84,473	319,026	524,076	456,628
Non-GAAP G&A Expenses	7,135,221	9,504,298	9,422,052	13,390,015	16,119,482
Net income (loss) attributable to Hollsys	13,084,751	(1,677,178)	(13,851,064)	25,704,538	41,469,998
Add: Amortization of discount and interest on notes payable related to bridge loan	6,401,975	3,244,434	-	-	-
Add: Stock-based compensation cost for incentive shares	-	17,000,000	39,240,000	-	95,338
Add: Stock-based compensation cost for options	-	84,473	319,026	524,076	456,628
Non-GAAP net income attributable to Hollsys	19,486,726	18,651,729	25,707,962	26,228,614	42,021,964
Weighted average ordinary shares	22,200,000	37,658,437	44,950,883	51,243,667	54,564,842
Weighted average number of diluted ordinary shares	22,883,836	38,664,032	50,015,536	51,838,294	54,949,280
Non-GAAP basic earnings per share	0.88	0.50	0.57	0.51	0.77
Non-GAAP diluted earnings per share	0.85	0.48	0.51	0.51	0.76

Exchange Rate Information

A majority of our business is conducted in China. We use U.S. dollars as our reporting currency in our financial statements and in this annual report. Monetary assets and liabilities denominated in Renminbi are translated into U.S. dollars at the rates of exchange as of the balance sheet date; equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the year as published by the Federal Reserve Bank of New York. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of other comprehensive income in the statement of changes in equity. Transactions and amounts in other parts of this annual report in Renminbi and other currencies are recorded at the rates of exchange prevailing when the transactions occurred. With respect to amounts not recorded in our consolidated financial statements included elsewhere in this annual report, all transactions from Renminbi into U.S. dollars and from U.S. dollars to Renminbi in this annual report on Form 20-F were made at a rate of RMB 6.4716 to \$1.00, as set forth by the Federal Reserve Bank of New York. We make no representation that any Renminbi, U.S. dollar or other currency amounts could have been, or could be, converted into the other stated currencies at any particular rate, the rates stated below, or at all. The Chinese government imposes control over its foreign-currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade. On September 16, 2011, the closing buying rate was RMB 6.3833 to \$1.00, as set forth by the Federal Reserve Bank of New York.

The following table sets forth information concerning exchange rates between the Renminbi and the U.S. dollar for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates

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that we used in this annual report on Form 20-F or will use in the preparation of our periodic reports or any other information to be provided to you.

Period	Period End	Exchange Rate		
		Average	Low	High
2006	7.8041	7.9579	8.0702	7.8041
2007	7.2946	7.5806	7.8127	7.2946
2008	6.8225	6.9193	7.2946	6.7800
2009	6.8259	6.8295	6.8470	6.8176
2010	6.6000	6.4356	6.7503	6.7861
January 31, 2011	6.6017	6.5964	6.6364	6.5809
February 28, 2011	6.5713	6.5761	6.5965	6.5520
March 31, 2011	6.5483	6.5645	6.5743	6.5483
April 29, 2011	6.5317	6.5382	6.5477	6.5310
May 31, 2011	6.4786	6.4957	6.4786	6.5073
June 30, 2011	6.4635	6.4746	6.4628	6.4830
July 29, 2011	6.4360	6.4575	6.4360	6.4720
August 29, 2011	6.3860	6.4072	6.3818	6.4401

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

An investment in our capital stock involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in this annual report, before making an investment decision. If any of the following risks actually occurs, our business, prospects, financial condition or results of operations could suffer. In that case, the trading price of our capital stock could decline, and you may lose all or part of your investment.

RISKS RELATED TO OUR BUSINESS

We will need to commit greater resources to new product and service development in order to stay competitive, and we may fail to offset the increased cost of such development with a sufficient increase in net sales or margins.

The success of our business depends in great measure on our ability to keep pace with, or even lead, changes that occur in our industry. Traditionally, the automation and control systems business was relatively stable and slow moving. Successive generations of products offered only marginal improvements in terms of functionality and reliability. However, the emergence of computers, computer networks and electronic components as key elements of the systems that we design and build has accelerated the pace of change in our industry. Where there was formerly as much as a decade or more between successive generations of automation systems, the time between generations is now as little as two to three years. Technological advances and the introduction of new products, new designs and new manufacturing techniques by our competitors could adversely affect our business unless we are able to respond with similar advances. To remain competitive, we must continue to incur significant costs in product development, equipment and facilities and to make capital investments. These costs may increase, resulting in greater fixed costs and operating expenses than we have incurred to date. As a result, we could be required to expend substantial funds for and commit significant resources to the following:

- Research and development activities on existing and potential product solutions;
 - Additional engineering and other technical personnel;
 - Advanced design, production and test equipment;
- Manufacturing services that meet changing customer needs;
 - Technological changes in manufacturing processes;
 - Expansion of manufacturing capacity; and
- Acquiring technology through licensing and acquisitions.

Our future operating results will depend to a significant extent on our ability to continue providing new product solutions that compare favorably on the basis of time to market, cost and performance, with competing third-party suppliers and technologies. Our failure to increase net sales sufficiently to offset the increased costs needed to achieve those advances would adversely affect our operating results.

We may experience trade barriers in expanding to our targeted emerging markets and may be subject to tariffs and taxes that will result in significant additional costs for our business and products.

We may experience barriers to conducting business and trade in our planned expansion to emerging markets. These barriers may be in the form of delayed customs clearances, customs duties or tariffs. In addition, we may be subject to repatriation taxes levied upon the exchange of income from local currency into foreign currency, substantial taxes of profits, revenues, assets and payroll, as well as value-added tax. The markets into which we may expand may impose onerous and unpredictable duties, tariffs and taxes on our business and products. These barriers or expenses could have an adverse effect on our operations and financial results.

We do not have long-term purchase commitments from our customers, so our customers are free to choose products from our competitors, which would result in a loss of revenue and profitability.

We are engaged in the design, production and installation of automation and process control systems. As a result, our revenues result from numerous individual contracts that, once completed, typically produce only a limited amount of ongoing revenues for maintenance and other services. Furthermore, customers may change or delay or terminate orders for products without notice for any number of reasons unrelated to us, including lack of market acceptance for the products to be produced by the process our system was designed to control. As a result, in order to maintain and expand our business, we must be able to replenish the orders in our pipeline on a continuous basis. It is possible that some of our potential customers could choose the products of our competitors. Should they do so, we would suffer a decline in revenues and profitability.

The success of our business depends, in part, on securing a steady stream of new customers.

Other than with our rail and nuclear plant customers, our average contract is worth approximately \$150,000. While some of those contracts are for upgrades and additions to existing control systems, most of them are for new installations. In order for our business to continue to succeed and grow, we need to secure contracts with new customers on a regular basis. We may not be successful in securing new contracts.

Although we do not have a concentration of business with any customer at this time, recently our business has become more dependent on a few significant customers.

We have developed significant customer relationships with the subway providers of several locals and the Ministry of Railways in respect of the high speed train system in China. We expect that these relationships will continue to grow, and we will win more contracts with them over time. We also are expanding into the business of control systems for nuclear plants which may develop into a significant customer base in the future. To the extent that these customer groups or specific customers with a group represent an increasing proportion of our business, we will become more dependent on them for our revenues and business growth. In that case, our cash flow also will become more dependent on those customers' payment practices and overall public funding policies, including the lengthening of collection times under performed contracts. Therefore, the loss of one or more of these customers or market groups as customers would have a material adverse impact on our revenues and our business operations and development.

We have a substantial backlog of contracts.

To date, our backlog has been a reflection of our ability to sell our products and services and increase our business. This represents an amount of unrealized revenue to be earned from contracts secured by the Company. Backlog, however, can also reflect our ability to perform our contracts on a timely basis. Therefore, when evaluating our backlog, analysis should be made of whether or not it is a reflection of an expanding business, improving marketing and increasing acceptance of our products and services in the marketplace.

A lack of adequate engineering resources could cause our business to lose profitability and potential business prospects.

Among the competitive advantages and key business advantages that we enjoy are the plentiful supply of engineering talent in China and the comparatively lower cost of our engineering staff compared to those of our Western and Japan-based competitors. Recently, however, our costs of these persons has been subject to increased wage pressures due to the economic growth of China and certain inflationary pressures and additional employment related taxation. If the available supply of engineers were to be absorbed by competing demands, or otherwise not as plentiful as we have experienced to date, then the cost of hiring, training and retaining capable engineers would likely increase. This could result in a reduction in our profitability and business prospects, or could even cause a change in our business strategy.

Our products may contain design or manufacturing defects, which could result in reduced demand for our products or services, customer claims and uninsured liabilities.

We manufacture spare parts for maintenance and replacement purposes after completion of integrated solution contracts to our customers' requirements, which can be highly complex and may at times contain design or manufacturing errors or defects. Any defects in the spare parts we manufacture may result in returns, claims, delayed shipments to customers or reduced or cancelled customer orders. If these defects occur, we will incur additional costs, and if they occur in large quantity or frequently, we may sustain additional costs, loss of business reputation and legal liability. Moreover, we are in the process of entering both the nuclear power generation and railway control systems sectors. Each of these sectors poses a substantially higher risk of liability in the event of a system failure, than was present in the industrial process controls markets in which we traditionally compete.

We may not be able to obtain adequate insurance coverage to protect us against these and other risks associated with our business. The typical practice of the industries with which we are involved is for the customers to obtain insurance to protect their own operational risks. Therefore, we currently do not carry any insurance coverage to protect against the risks related to product failure. However, it is possible that such customers or their insurers could assert claims against us for any damages caused by a failure in one of our systems, and as a result, the failure of any of our products could result in a liability that would seriously impair our financial condition or even force us out of business.

Our failure to adequately protect our intellectual property rights may undermine our competitive position, and litigation to protect our intellectual property rights may be costly.

Our business is based on a number of proprietary products and systems, some of which are patented, others of which we protect as trade secrets. We strive to strengthen and differentiate our product portfolio by developing new and innovative products and product improvements. As a result, we believe that the protection of our intellectual property will become increasingly important to our business as the functionality of automation systems increases to meet customer demand and as we try to open new markets for our products. Implementation and enforcement of intellectual property-related laws in China has historically been lacking due primarily to ambiguities in PRC intellectual property

law. Accordingly, protection of intellectual property and proprietary rights in China may not be as effective as in the United States or other countries. Currently, we hold 88 PRC utility patents that relate to various product configurations and product components and 90 software copyrights and have 44 pending PRC patent applications. We will continue to rely on a combination of patents, trade secrets, trademarks and copyrights to provide protection in this regard, but this protection may be inadequate.

For example, our pending or future patent applications may not be approved or, if allowed, they may not be of sufficient strength or scope. As a result, third parties may use the technologies and proprietary processes that we have developed and compete with us, which could negatively affect any competitive advantage we enjoy, dilute our brand and harm our operating results.

In addition, policing the unauthorized use of our proprietary technology can be difficult and expensive. Litigation may be necessary to enforce our intellectual property rights and given the relative unpredictability of China's legal system and potential difficulties enforcing a court judgment in China, there is no guarantee litigation would result in an outcome favorable to us. Furthermore, any such litigation may be costly and may divert management attention away from our core business. An adverse determination in any lawsuit involving our intellectual property is likely to jeopardize our business prospects and reputation. We have no insurance coverage against litigation costs so we would be forced to bear all litigation costs if we cannot recover them from other parties. All of the foregoing factors could harm our business and financial condition.

We may develop new products that do not gain market acceptance, which would result in the failure to recover the significant costs for design and manufacturing services for new product solutions, thus adversely affecting operating results.

We operate in an industry characterized by increasingly frequent and rapid technological advances, product introductions and new design and manufacturing improvements. As a result, we must expend funds and commit resources to research and development activities, possibly requiring additional engineering and other technical personnel; purchasing new design, production, and test equipment; and enhancing our design and manufacturing processes and techniques. We may invest in equipment employing new production techniques for existing products and new equipment in support of new technologies that fail to generate adequate returns on the investment due to insufficient productivity, functionality or market acceptance of the products for which the equipment may be used. We could, therefore, incur significant costs for design and manufacturing services for new product solutions that do not generate a sufficient return on that investment, which would adversely affect our future operating results. Our future operating results will depend significantly on our ability to provide timely design and manufacturing services for new products that compete favorably with design and manufacturing capabilities of third party suppliers.

RISKS RELATING TO THE INDUSTRY IN WHICH WE OPERATE

Our plans for growth rely on an increasing emphasis on railroad, subway and nuclear power sectors, and these sectors present fewer business opportunities, so we may not be successful in growing these new markets.

While the principal focus of our business until recently has been to provide Distributed Control Systems to industrial and manufacturing companies, our plans for growth include an increasing emphasis on railroad and subway control systems and nuclear power generation control systems. These sectors generally present fewer business opportunities during a given period relative to the industrial and manufacturing sectors. However, the average size of the contracts in those sectors tends to be much larger, and as a result, the competition for such contracts is substantial. We may not be successful in entering these new markets and, if it is unable to do so, our revenues and profits may not be as robust as anticipated, resulting in a decreased value of our stock.

To the extent that we devote more of our marketing and business capacities to these customers, our revenues and business development will be more dependent on our being able to service their needs. To the extent that the nuclear industry and high speed railway in China may experience slowed growth, we would expect that there would be a slowing of our expansion into these business areas.

Although China is committed to expanding its energy production with nuclear power and building a high speed railway network, both these industries have experienced various setbacks due to higher than expected accidents due to natural disasters and operational error. To the extent that the government slows their development and expansion within these two industries on which we are becoming more reliant, we may experience a slowing of our business growth due the inability to win contracts or our ability to win contracts for smaller amounts than previously experienced and anticipated. If we are unable to generate the revenues that we seek and we are unable to replace the revenues in our traditional markets or other new markets, then we will likely experience slower growth or possibly even a reduction in revenues.

To the extent that our business is more dependent on large contracts and contracts from a few customers, our revenues, cash flow and profits will be influenced by this type of contracting and the timely payment for our products and services.

As we develop our business with the entities responsible for building municipal subway systems and railroads we will be entering into contracts for larger sized projects than in the past for significantly greater value. Therefore, our revenues, cash flow and profit will become increasingly dependent on our ability to perform these contracts and collect the payments due on a timely basis. As many of the entities that are contracting with us are governmental authorities or ministries, our contracting and collections will become subject to these entities being able to adequately budget and have the revenues to timely pay for our products and services. To some extent, we may become subject to delays and reductions in scope of project due to changes in the policies, objectives and budgeting of any of the public entities which control the projects on which we are contracting.

At this time, contracting with the entities that provide the subway and rail systems for which we provide control systems is similar to contracting with the customers we have sold to in the past. Therefore, our contracts are written on a similar basis as before, and we expect that we will be operating under these contracts and accounting for their revenues in a similar manner as before.

Many of our competitors have substantially greater resources than we do, allowing them to be able to reduce their prices, which would force us to reduce our prices.

We operate in a very competitive environment with many major international and domestic companies, such as Honeywell, General Electric, ABB, Siemens, Emerson and Hitachi. Many of our competitors are much better established and more experienced than we are, have substantially greater financial resources, operate in many international markets and are much more diversified than we are. As a result, they are in a strong position to compete effectively with us by, for example, reducing their prices, which could force us to reduce our prices. These large competitors are also in a better position than we are to weather any extended weaknesses in the market for automation and control systems. Other emerging companies or companies in related industries may also increase their participation in our market, which would add to the competitive pressures that we face.

A decrease in the rate of growth in Chinese industry and the Chinese economy in general may lead to a decrease in our revenues because industrial companies in China are the principal current source of revenues for us.

Industrial companies operating in China are the principal current source of revenues for us. Our business benefited in the past from the rapid expansion of China's industrial activity, which has created additional demand from existing companies and led to the formation of numerous additional companies that have need for our products and services. China's industrial expansion has been fueled in large measure by international demand for the low-cost goods that China is able to produce due to labor advantages and other comparative advantages, such as governmental subsidies to offset research and development expenses and taxes and reduced land use/facilities costs for targeted industries. The Chinese economy may not be able to sustain this rate of growth in the future, and any reduction in the

rate of China's industrial growth or a shrinking of China's industrial base could adversely affect our revenues. The resulting increase in competition for customers might also cause erosion of profit margins that we have been able to achieve historically.

Our plans to enter the international automation market may not prove successful, and we may waste capital resources and needlessly divert management's time and attention from our principal market.

To date, we have conducted nearly all of our business within China and Southeast Asia. However, we have plans to further penetrate international markets in the near future, emphasizing Southeast Asia and the Middle East. Our expansion is likely to use substantial resources, including substantial amounts of capital and equity and deploy meaningful amounts of management time and attention. Our products and our overall approach to the automation and controls system business may not be accepted in other markets to the extent needed to make that effort profitable. In addition, the additional demands on our management from these activities may detract from our efforts in the domestic Chinese market and market of surrounding countries, causing the operating results in our principal markets to be adversely affected.

We depend heavily on key personnel, and loss of key employees and senior management could harm our business.

Our future business and results of operations depend in significant part upon the continued contributions of our key technical and senior management personnel, including Dr. Changli Wang, our Chairman, Chief Executive Officer and President, and Mr. Peter Li, our Chief Financial Officer. They also depend in significant part upon our ability to attract and retain additional qualified management, technical, marketing and sales and support personnel for our operations. If we lose a key employee, if a key employee fails to perform in his or her current position or if we are not able to attract and retain skilled employees as needed, our business could suffer. Turnover in our senior management could significantly deplete institutional knowledge held by our existing senior management team and impair our operations.

In addition, if any of these key personnel joins a competitor or forms a competing company, we may lose some of our customers. We have entered into confidentiality and non-competition agreements with all of these key personnel. However, if any disputes arise between these key personnel and us, it is not clear, in light of uncertainties associated with the PRC legal system, what the court decisions will be and the extent to which these court decisions could be enforced in China, where all of these key personnel reside and hold some of their assets. See “—Risks Related to Doing Business in China—Uncertainties with respect to the PRC legal system could limit the legal protections available to you and us.”

Our control systems are used in infrastructure projects such as subway systems, surface railways and nuclear plants; to the extent that our systems do not perform as designed, we could be found responsible for the damage resulting from that failure.

We face potential responsibility for the failure of our control systems in performing the various functions for which they are designed and the damages resulting from any such problem. To the extent that we contract to provide control systems in larger scale projects, the level of damages for which we may be held responsible is likely to increase. To the extent that any of our installed control systems do not perform as designed for their intended purposes, and we are held responsible for the consequences of those performance failures and resulting damages, there may be an adverse impact on our business, business reputation, revenues and profits. To date, we do not believe any of our control systems have not performed as designed and no claims to any significant degree have been asserted against us based on a non-performance event. Notwithstanding our record, no assurance can be given that no claims will be sought in the future based on the design and performance of our control systems.

We may be exposed to potential risks relating to our internal controls over financial reporting and our ability to have those controls positively attested to by our independent auditors.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the SEC adopted rules requiring public companies to include a report of management on the Company's internal controls over financial reporting in their annual reports and the independent registered public accounting firm auditing a company's financial statements to attest to and report on the operating effectiveness of such company's internal controls. Although our independent auditor has provided a positive attestation as of June 30, 2011, we can provide no assurance that we will comply with all of the requirements imposed thereby and we will receive a positive attestation from our independent auditors in the future. In the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner or we are unable to receive a positive attestation from our independent auditors with respect to our internal controls, investors and others may lose confidence in the reliability of our financial statements.

RISKS RELATED TO DOING BUSINESS IN CHINA

Substantially all of our operating assets are located in China and substantially all of our revenue will be derived from our operations in China so our business, results of operations and prospects are subject to the economic, political and legal policies, developments and conditions in China.

The PRC's economic, political and social conditions, as well as government policies, could impair our business. The PRC economy differs from the economies of most developed countries in many respects. China's GDP has grown consistently since 1978 (National Bureau of Statistics of China). However, we cannot assure you that such growth will be sustained in the future. If, in the future, China's economy experiences a downturn or grows at a slower rate than expected, there may be less demand for spending in certain industries. A decrease in demand for spending in certain industries could impair our ability to remain profitable. The PRC's economic growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may have a negative effect on us. For example, our financial condition and results of operations may be hindered by PRC government control over capital investments or changes in tax regulations.

The PRC economy has been transitioning from a planned economy to a more market-oriented economy. Although in recent years the PRC government has implemented measures emphasizing the use of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. It also exercises significant control over PRC economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies.

If the China Securities Regulatory Commission, or CSRC, or another PRC regulatory agency, determines that CSRC approval of our initial merger was required or if other regulatory obligations are imposed upon us, we may incur sanctions, penalties or additional costs which would damage our business

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the Regulations on Mergers and Acquisitions of Domestic Companies by Foreign Investors, or the M&A Regulations, which became effective on September 8, 2006. Under these regulations, the prior approval of the CSRC is required for the overseas listing of offshore special purpose vehicles that are directly or indirectly controlled by PRC companies or individuals and used for the purpose of listing PRC onshore interests on an overseas stock exchange.

On September 20, 2007, we completed a merger transaction with Chardan North China Acquisition Corporation, or Chardan, which resulted in our current ownership and corporate structure. We believe that CSRC approval was not required for our merger transaction or for the listing and trading of our securities on a trading market because we are not an offshore special purpose vehicle that is directly or indirectly controlled by PRC companies or individuals. Although the M&A Regulations provide specific requirements and procedures, there are still many ambiguities in the meaning of many provisions. Further regulations are anticipated in the future, but until there has been clarification either by pronouncements, regulation or practice, there is some uncertainty in the scope of the regulations and the regulators have wide latitude in the enforcement of the regulations and approval of transactions. If the CSRC or another PRC regulatory agency subsequently determines that the CSRC's approval was required, we may face sanctions by the CSRC or another PRC regulatory agency. If this happens, these regulatory agencies may impose fines and penalties on our operations in China, limit our operating privileges in China, restrict or prohibit payment or remittance of dividends paid by Hollysys, or take other actions that could damage our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our securities.

We anticipate that the PRC will experience inflation in the near term, which may have an adverse effect on our cost of operations and profitability.

The PRC economy is experiencing inflationary pressures in various ways due to a number of factors. It is anticipated that all businesses within the PRC, including Hollysys, will experience increasing costs resulting from the pressure to increase wages, the imposition of new employment related taxation, the increase in interest rates, and the increase in the value of the Renmenbi, among other things. If we are unable to increase the value of our contracts commensurate with increases in our operating expenses, we will experience a reduction in our profit margins. If we raise our contract prices, we may not win the kind and amount of contracts that will permit us to operate profitably and grow our business.

If the PRC imposes restrictions designed to reduce inflation, future economic growth in the PRC could be severely curtailed which could hurt our business and profitability.

While the economy of the PRC has experienced rapid growth, this growth has been uneven among various sectors of the economy and in different geographical areas of the country. Rapid economic growth often can lead to growth in the supply of money and rising inflation. In order to control inflation in the past, the PRC has imposed controls on bank credits, limits on loans for fixed assets and restrictions on state bank lending. Imposition of similar restrictions may lead to a slowing of economic growth, a decrease in demand for our products and generally damage our business and profitability.

Fluctuations in exchange rates could harm our business and the value of our securities.

The value of our securities will be indirectly affected by the foreign exchange rate between U.S. dollars and RMB and between those currencies and other currencies in which our sales may be denominated. Because substantially most of our earnings and cash assets are denominated in RMB and our financial results are reported in U.S. dollars, fluctuations in the exchange rate between the U.S. dollar and the RMB will affect our balance sheet and our earnings per share in U.S. dollars. In addition, appreciation or depreciation in the value of the RMB relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars as well as earnings from, and the value of, any U.S. dollar-denominated investments we make in the future. Since July 2005, the RMB has no longer been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future PRC authorities may lift

restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions. While we may enter into hedging transactions in the future, the availability and effectiveness of these transactions may be limited, and we may not be able to successfully hedge our exposure at all. In addition, our foreign currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into foreign currencies.

Exchange controls that exist in the PRC may limit our ability to utilize our cash flow effectively.

We are subject to the PRC's rules and regulations on currency conversion. In the PRC, the State Administration for Foreign Exchange, or SAFE, regulates the conversion of the RMB into foreign currencies. Currently, foreign investment enterprises, or FIEs, are required to apply to the SAFE for "Foreign Exchange Registration Certificates for FIEs." We believe Beijing Helitong is an FIE. With such registration certificates, which need to be renewed annually, FIEs are allowed to open foreign currency accounts including a "basic account" and "capital account." Currency conversion within the scope of the "basic account," such as remittance of foreign currencies for payment of dividends, can be effected without requiring the approval of the SAFE. However, conversion of currency in the "capital account," including capital items such as direct investment, loans and securities, still require approval of the SAFE. We cannot assure you that the PRC regulatory authorities will not impose further restrictions on the convertibility of the RMB. Any future restrictions on currency exchanges may limit our ability to use our cash flow for the distribution of dividends to our shareholders or to fund operations it may have outside of the PRC.

A failure by our shareholders or beneficial owners who are PRC citizens or residents in China to comply with certain PRC foreign exchange regulations could restrict our ability to distribute profits, restrict our overseas and cross-border investment activities or subject us to liability under PRC laws.

Notice on Issues Relating to Administration of Foreign Exchange in Fund-raising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or Notice 75, was issued on October 21, 2005 by SAFE (that replaced two previously issued regulations on January 24, 2005 and April 8, 2005, respectively) that requires approvals from, and registrations with, PRC government authorities in connection with direct or indirect offshore investment activities by PRC residents and PRC corporate entities. The SAFE regulations require retroactive approval and registration of direct or indirect investments previously made by PRC residents in offshore companies. In the event that a PRC shareholder with a direct or indirect stake in an offshore parent company fails to obtain the required SAFE approval and make the required registration, the PRC subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Further, failure to comply with the various SAFE approval and registration requirements described above, as currently drafted, could result in liability under PRC law for foreign exchange evasion.

Although SAFE issued an implementation Notice No. 106, or Notice 106, on May 29, 2007 to local branches or agencies, because of the uncertainty as to when and how the new procedure and requirements will take effect or be enforced, and uncertainty concerning the reconciliation of the new regulations with other approval requirements, it remains unclear how these existing regulations, and any future legislation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. Although we are committed to complying with the relevant rules, we cannot assure you that we will never have shareholders or beneficial owners who are PRC citizens or residents, or that such persons have always complied with and will in the future make or obtain any applicable registrations or approvals required by SAFE Circular 75, Notice 106 or other related regulations. Failure by such shareholders or beneficial owners to comply with SAFE Circular 75 and Notice 106 could subject us to fines or legal sanctions, restrict our overseas or cross-border investment activities, limit our subsidiary's ability to make distributions or pay dividends or affect our ownership structure, which could adversely affect our business and prospects.

Because Chinese law governs many of our material agreements, we may not be able to enforce our rights within the PRC or elsewhere, which could result in a significant loss of business, business opportunities or capital.

Chinese law governs many of our material agreements, some of which may be with Chinese governmental agencies. We cannot assure you that we will be able to enforce any of our material agreements or that remedies will be available outside of the PRC. The system of laws and the enforcement of existing laws and contracts in the PRC may not be as certain in implementation and interpretation as in the United States. The Chinese judiciary is relatively inexperienced in enforcing corporate and commercial law, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. The inability to enforce or obtain a remedy under any of our future agreements could result in a significant loss of business, business opportunities or capital.

Our management is unfamiliar with United States securities laws and will have to expend time and resources becoming familiar with such laws which could lead to various regulatory issues.

Many members of our management team are not familiar with United States securities laws and will have to expend time and resources becoming familiar with such laws. This could be expensive and time-consuming and could lead to various regulatory issues and a diversion of management attention, which may harm our operations.

The ability of our Chinese operating subsidiary to pay certain foreign currency obligations, including dividends, is subject to restrictions.

Our ability to pay dividends may be restricted due to the foreign exchange control policies and availability of cash balances. Since substantially all of our operations are conducted in China and a majority of our revenues are generated in China, a significant portion of our revenue earned and currency received are denominated in RMB. The Chinese government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of China. RMB is currently not a freely convertible currency. Shortages in the availability of foreign currency may restrict our ability to remit sufficient foreign currency to pay dividends, if any, on our ordinary shares or otherwise satisfy foreign currency denominated obligations. Under existing Chinese foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from the transaction, can be made in foreign currencies without prior approval from the State Administration of Foreign Exchange by complying with certain procedural requirements. However, approval from appropriate governmental authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies. The Chinese government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay certain of our expenses as they come due. In addition, current regulations in China permit Chinese subsidiaries to pay dividends to us only out of their accumulated distributable profits, if any, determined in accordance with Chinese accounting standards and regulations. In addition, Chinese subsidiaries are required to set aside at least 10% of its accumulated profits each year. Such reserve account may not be distributed as cash dividends.

If any dividend is declared in the future and paid in a foreign currency, you may be taxed on a larger amount in U.S. dollars than the U.S. dollar amount that you will actually ultimately receive.

If you are a U.S. holder, you will be taxed on the U.S. dollar value of your dividends at the time you receive them, even if you actually receive a smaller amount of U.S. dollars when the payment is in fact converted into U.S. dollars. Specifically, if a dividend is declared and paid in a foreign currency, the amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the payments made in the foreign currency, determined at the conversion rate of the foreign currency to the U.S. dollar on the date the dividend

distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Thus, if the value of the foreign currency decreases before you actually convert the currency into U.S. dollars, you will be taxed on a larger amount in U.S. dollars than the U.S. dollar amount that you will actually ultimately receive.

Our business could be severely harmed if the Chinese government changes its policies, laws, regulations, tax structure or its current interpretations of its laws, rules and regulations relating to our operations in China.

Our manufacturing facility is located in China and virtually all of our assets are located in China. We generate our sales revenue from customers located in China. Our results of operations, financial state of affairs and future growth are, to a significant degree, subject to China's economic, political and legal development and related uncertainties. Our operations and results could be materially affected by a number of factors, including, but not limited to

- Changes in policies by the Chinese government resulting in changes in laws or regulations or the interpretation of laws or regulations,
 - changes in taxation,
 - changes in employment restrictions,
 - restrictions on imports and sources of supply,
 - import duties, and
 - currency revaluation.

Over the past several years, the Chinese government has pursued economic reform policies including the encouragement of private economic activities and greater economic decentralization. If the Chinese government does not continue to pursue its present policies that encourage foreign investment and operations in China, or if these policies are either not successful or are significantly altered, then our business could be harmed. Following the Chinese government's policy of privatizing many state-owned enterprises, the Chinese government has attempted to augment its revenues through increased tax collection. It also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Continued efforts to increase tax revenues could result in increased taxation expenses being incurred by us. Economic development may be limited as well by the imposition of austerity measures intended to reduce inflation, the inadequate development of infrastructure and the potential unavailability of adequate power and water supplies, transportation and communications. In addition, the Chinese government continues to play a significant role in regulating industry by imposing industrial policies.

The Chinese laws and regulations which govern our current business operations are sometimes vague and uncertain and may be changed in a way that hurts our business.

China's legal system is a civil law system based on written statutes, in which system decided legal cases have little value as precedents, unlike the common law system prevalent in the United States. There are substantial uncertainties regarding the interpretation and application of Chinese laws and regulations, including but not limited to the laws and regulations governing our business, or the enforcement and performance of our arrangements with customers in the event of the imposition of statutory liens, death, bankruptcy and criminal proceedings. The Chinese government has been developing a comprehensive system of commercial laws, and considerable progress has been made in introducing laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, because these laws and regulations are relatively new, and because of the limited volume of published cases and judicial interpretation and their lack of force as precedents, interpretation and enforcement of these laws and regulations involve significant uncertainties. New laws and regulations that affect existing and proposed future businesses may also be applied retroactively. We are considered an FIE under Chinese laws, and as a result, we must comply with Chinese laws and regulations. We cannot predict what effect the interpretation of existing or new Chinese laws or regulations may have on our business. If the relevant authorities find us to be in violation of Chinese laws or regulations, they would have broad discretion in dealing with such a violation, including, without limitation: levying fines; revoking our business and other licenses; requiring that we restructure our ownership or operations; and requiring that we discontinue any portion or all of our business.

A slowdown or other adverse developments in the Chinese economy may materially and adversely affect our customers' demand for our services and our business.

Almost all of our operations are conducted in China and most of our revenues are generated from sales to businesses operating in China. Although the Chinese economy has grown significantly in recent years, such growth may not continue. We do not know how sensitive we are to a slowdown in economic growth or other adverse changes in Chinese economy which may affect demand for our products. A slowdown in overall economic growth, an economic downturn or recession or other adverse economic developments in China may materially reduce the demand for our products and in turn reduce our results of operations.

The implementation of the changes in the laws relating to PRC employment are likely to result in increased labor costs in China, which may hurt our business and profitability.

A new employment contract law became effective on January 1, 2008 in China. It imposes more stringent requirements on employers in relation to entry into fixed-term employment contracts, recruitment of temporary employees and dismissal of employees. In addition, under the newly promulgated Regulations on Paid Annual Leave for Employees, which also became effective on January 1, 2008, employees who have worked continuously for more than one year are entitled to paid vacation time ranging from 5 to 15 days, depending on the length of the employee's service. Employees who waive such vacation entitlements at the request of the employer will be compensated for three times their normal daily salaries for each vacation day so waived. On July 1, 2011, China promulgated the Social Insurance Law to unify previous scattered laws relating to social insurance matters. The new law clarifies that the social insurance system in China includes pension insurance, medical insurance, unemployment insurance, work-related injury insurance and maternity insurance, all of which are mandatory benefits for employees of companies operating in China. Employers are required to make contributions under these insurance schemes, which although local in rates, are overall expected to increase employee expense over time. As a result of the new laws and regulations, our labor costs have increased and we anticipate that there will be increases these and similar costs in the future. There is no assurance that disputes, work stoppages or strikes will not arise in the future over these and other matters. Increases in the labor costs or future disputes with our employees could damage our business, financial condition or operating results.

The Chinese government has been adopting increasingly stringent environmental, health and safety protection requirements, which could hurt our business.

The continuance of our operations depends upon compliance with the applicable environmental, health and safety, fire prevention and other regulations. Any change in the scope or application of these laws and regulations may limit our production capacity or increase our cost of operation and could therefore have an adverse effect on our business operations, financial condition and operating results. Our failure to comply with these laws and regulations could result in fines, penalties or legal proceedings. There can be no assurance that the Chinese government will not impose additional or stricter laws or regulations, compliance with which may cause us to incur significant capital expenditures, which it may not be able to pass on to our customers.

Under the New EIT Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC shareholders.

China passed a new Enterprise Income Tax Law, or the New EIT Law, and its implementing rules, both of which became effective on January 1, 2008. Under the New EIT Law, an enterprise established outside of China with “de facto management bodies” within China is considered a “resident enterprise,” meaning that it can be treated in a manner similar to a Chinese domestic enterprise for enterprise income tax purposes. The implementing rules of the New EIT Law define de facto management as “substantial and overall management and control over the production and operations, personnel, accounting, and properties” of the enterprise.

On April 22, 2009, the State Administration of Taxation issued the Notice Concerning Relevant Issues Regarding Cognizance of Chinese Investment Controlled Enterprises Incorporated Offshore as Resident Enterprises pursuant to Criteria of de facto Management Bodies, or the Notice, further interpreting the application of the New EIT Law and its implementation non-Chinese enterprise or group controlled offshore entities. Pursuant to the Notice, an enterprise incorporated in an offshore jurisdiction and controlled by a Chinese enterprise or group will be classified as a “non-domestically incorporated resident enterprise” if (i) its senior management in charge of daily operations reside or perform their duties mainly in China; (ii) its financial or personnel decisions are made or approved by bodies or persons in China; (iii) substantial assets and properties, accounting books, corporate chops, board and shareholder minutes are kept in China; and (iv) at least half of its directors with voting rights or senior management often resident in China. A resident enterprise would be subject to an enterprise income tax rate of 25% on its worldwide income and must pay a withholding tax at a rate of 10% when paying dividends to its non-PRC shareholders. However, it remains unclear as to whether the Notice is applicable to an offshore enterprise incorporated by a Chinese natural person. Nor are detailed measures on imposition of tax from non-domestically incorporated resident enterprises available. Therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

We may be deemed to be a resident enterprise by Chinese tax authorities. If the PRC tax authorities determine that Hollsys is a “resident enterprise” for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to the enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest on financing proceeds and non-China source income would be subject to PRC enterprise income tax at a rate of 25%. Second, although under the New EIT Law and its implementing rules, dividends paid to us from our PRC subsidiaries would qualify as “tax-exempt income,” we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for PRC enterprise income tax purposes. Finally, it is possible that future guidance issued with respect to the new “resident enterprise” classification could result in a situation in which a 10% withholding tax is imposed on dividends we pay to our non-PRC shareholders and with respect to gains derived by our non-PRC shareholders from transferring our shares.

We do not expect any impact on our business and operations under the new EIT Law and its implementing rules as we do not have non-PRC income.

RISKS RELATED TO OUR SHARES

The market price of our ordinary shares is volatile, leading to the possibility of its value being depressed at a time when you want to sell your holdings.

The market price of our ordinary shares is volatile, and this volatility may continue. Numerous factors, many of which are beyond our control, may cause the market price of our ordinary shares to fluctuate significantly. These

factors include:

- our earnings releases, actual or anticipated changes in our earnings, fluctuations in our operating results or our failure to meet the expectations of financial market analysts and investors;

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- changes in financial estimates by us or by any securities analysts who might cover our stock;
 - speculation about our business in the press or the investment community;
 - significant developments relating to our relationships with our customers or suppliers;
- stock market price and volume fluctuations of other publicly traded companies and, in particular, those that are in the same industry as we are;
 - customer demand for our products;
- investor perceptions of the automation and control industry in general and our company in particular;
 - the operating and stock performance of comparable companies;
 - general economic conditions and trends;
 - major catastrophic events;
- announcements by us or our competitors of new products, significant acquisitions, strategic partnerships or divestitures;
 - changes in accounting standards, policies, guidance, interpretation or principles;
 - loss of external funding sources;
 - failure to maintain compliance with Nasdaq rules;
- sales of our ordinary shares, including sales by our directors, officers or significant shareholders; and
 - additions or departures of key personnel.

Securities class action litigation is often instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs to us and divert our management's attention and resources.

Moreover, securities markets may from time to time experience significant price and volume fluctuations for reasons unrelated to operating performance of particular companies. For example, from October until June 2009, securities markets in the United States, China and throughout the world experienced a historically large decline in share price. These market fluctuations may adversely affect the price of our ordinary shares and other interests in our company at a time when you want to sell your interest in us.

We are a "foreign private issuer," and have disclosure obligations that are different than those of other U.S. domestic reporting companies so you should not expect to receive the same information about us at the same time as a U.S. domestic reporting company may provide.

We are a foreign private issuer and, as a result, we are not subject to certain of the requirements imposed upon U.S. domestic issuers by the SEC. For example, we are not required to issue quarterly reports or proxy statements. Through the fiscal year ended June 30, 2011, we are allowed six months to file our annual report with the SEC and thereafter must file our annual report within four months of our fiscal year end. We are not required to disclose certain detailed information regarding executive compensation that is required from U.S. domestic issuers. Further, our directors and executive officers are not required to report equity holdings under Section 16 of the Securities Act. As a foreign private issuer, we are also exempt from the requirements of Regulation FD (Fair Disclosure) which, generally, are meant to ensure that select groups of investors are not privy to specific information about an issuer before other investors. We are, however, still subject to the anti-fraud and anti-manipulation rules of the SEC, such as Rule 10b-5. Since many of the disclosure obligations required of us as a foreign private issuer are different than those required by other U.S. domestic reporting companies, our shareholders should not expect to receive information about us in the same amount and at the same time as information is received from, or provided by, other U.S. domestic reporting companies. We are liable for violations of the rules and regulations of the SEC which do apply to us as a foreign private issuer. Violations of these rules could affect our business, results of operations and financial condition.

We do not intend to pay dividends on our ordinary shares for the foreseeable future.

We intend to retain any future earnings to fund the operation and expansion of our business and, therefore, we do not anticipate paying cash dividends on our ordinary shares in the foreseeable future.

You may have difficulty enforcing judgments obtained against us.

We are a BVI company and substantially all of our assets are located outside of the United States. Virtually all of our assets and a substantial portion of our current business operations are conducted in the PRC. In addition, our directors and officers are nationals and residents of countries other than the United States. The assets of these persons are located mostly outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce in U.S. courts judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors. In addition, there is uncertainty as to whether the courts of the British Virgin Islands or the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state. In addition, it is uncertain whether such British Virgin Islands or PRC courts would be competent to hear original actions brought in the BVI or the PRC against us or such persons predicated upon the securities laws of the United States or any state.

Because we are incorporated under the laws of the BVI, it may be more difficult for our shareholders to protect their rights than it would be for a shareholder of a corporation incorporated in another jurisdiction.

Our corporate affairs are governed by our Memorandum and Articles of Association and by the BVI Business Companies Act, 2004 of the BVI. Principles of law relating to such matters as the validity of corporate procedures, the fiduciary duties of management and the rights of our shareholders differ from those that would apply if we were incorporated in the United States or another jurisdiction. The rights of shareholders under BVI law are not as clearly established as are the rights of shareholders in many other jurisdictions. Under the laws of most jurisdictions in the United States, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders. Shareholder action must be taken in good faith, and actions by controlling shareholders which are obviously unreasonable may be declared null and void. BVI law protecting the interests of minority shareholders may not be as protective in all circumstances as the law protecting minority shareholders in US jurisdictions. In addition, the circumstances in which a shareholder of a BVI company may sue the company derivatively, and the procedures and defenses that may be available to the company, may result in the rights of shareholders of a BVI company being more limited than those of shareholders of a company organized in the US. Furthermore, our directors have the power to take certain actions without shareholder approval which would require shareholder approval under the laws of most US jurisdictions. The directors of a BVI corporation, subject in certain cases to court approval but without shareholder approval, may implement a reorganization, merger or consolidation, the sale of any assets, property, part of the business, or securities of the corporation. The ability of our board of directors to create new classes or series of shares and the rights attached by amending our Memorandum of Association and Articles of Association without shareholder approval could have the effect of delaying, deterring or preventing a change in our control without any further action by the shareholders, including a tender offer to purchase our ordinary shares at a premium over then current market prices. Thus, our shareholders may have more difficulty protecting their interests in the face of actions by our board of directors or our controlling shareholders than they would have as shareholders of a corporation incorporated in another jurisdiction.

We may be classified as a passive foreign investment company, which could result in adverse United States federal income tax consequences to U.S. shareholders.

We believe that we are not considered a “passive foreign investment company,” or PFIC, for United States federal income tax purposes for our tax year ended June 30, 2011. However, each year we must make a separate determination as to whether we are a PFIC. We cannot assure you that we will not be a PFIC for our tax year ending June 30, 2012 or any following tax year. If a non-U.S. corporation either (i) at least 75% of its gross income is passive income for a tax year or (ii) at least 50% of the value of its assets (based on an average of the quarterly values of the assets during a tax year) is attributable to assets that produce or are held for the production of passive income, then the non-U.S. corporation will be deemed a PFIC. The market value of our assets may be determined to a large extent by the market price of our ordinary shares, which is likely to fluctuate after this offering. Furthermore, how we spend as well as how quickly we spend the proceeds from the offering will affect the composition of our income and assets. If we are treated as a PFIC for any tax year during which U.S. shareholders hold ordinary shares, certain adverse United States federal income tax consequences could apply to such U.S. holders.

Our Shareholder Rights Plan and charter documents may hinder or prevent change of control transactions.

Our shareholder rights plan and provisions contained in our Memorandum and Articles of Association may discourage transactions involving an actual or potential change in our ownership. In addition, our Memorandum and Articles of Association authorizes our board of directors to issue up to 90,000,000 shares of preferred stock without any further action by the stockholders. Please see Item 10, Additional Information for more information regarding our shareholder rights plan. Such restrictions and issuances could make it more difficult, delay, discourage, prevent or make it more costly to acquire or effect a change-in-control, which in turn could prevent our stockholders from recognizing a gain in the event that a favorable offer is extended and could materially and negatively affect the market price of our ordinary shares, even if you or our other stockholders believe that such actions are in the best interests of us and our stockholders.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were established under the laws of the BVI on February 6, 2006, as HLS Systems International, Ltd., in order to merge with Chardan, a Delaware special purpose acquisition company, originally established on March 10, 2005, with the primary purpose of effecting a business combination with an unidentified operating business that has its primary operating facilities located in China, in any city or province north of Yangtze River. On September 20, 2007, we acquired all of the issued and outstanding ordinary shares of Gifted Time, a BVI company. Simultaneously with the acquisition, Chardan merged with and into us, all of the common stock of Chardan was converted into our ordinary shares, on a one-to-one basis, and we assumed the then outstanding Chardan warrants. As a result of the foregoing transactions, we acquired a controlling interest in Beijing Hollysys and Hangzhou Hollysys, and an indirect interest in their majority and minority owned subsidiaries, and the consolidated financial statements of Beijing Hollysys and Hangzhou Hollysys became our historical financial statements for accounting and reporting purposes. On July 17, 2009, we changed our name to Hollysys Automation Technologies Ltd. to more accurately reflect our core value of leveraging proprietary technologies to provide state-of-the-art automation and control solutions for our clients.

Gifted Time and Subsidiaries

Gifted Time was established under the laws of the BVI on September 21, 2005, as a holding company for our indirect PRC subsidiaries, Beijing Hollysys and Hangzhou Hollysys.

Beijing Hollysys was established in September 1996 as a domestic Chinese company based in Beijing, China. From inception, Beijing Hollysys has been engaged in designing, developing and manufacturing automation control systems for customers throughout China. Beijing Hollysys offers integrated automation solutions for many industries, including electric power generation, transmission and distribution, manufacturing (including metallurgy, construction materials, petrochemical and pharmaceutical industries), and railroad transportation. Beijing Hollysys' integrated automation systems and solutions have enabled customers to improve the safety, reliability and efficiency of their manufacturing processes and significantly enhance the customers' overall profitability. Hangzhou Hollysys was established as an equity joint venture under Chinese laws in September 2003. The operations of Hangzhou Hollysys focus on industrial automation and integrated solutions.

During the period from December 2007 to March 2008, we established a series of wholly owned subsidiaries, namely (i) Beijing Hollysys S&T, a Chinese domestic enterprise which acquired the original shareholders' 74.11% equity interest in Beijing Hollysys; (ii) Beijing Helitong, a wholly foreign owned enterprise in China which acquired the original shareholders' 100% equity interest in Beijing Hollysys S&T; (iii) World Hope, a Hong Kong company which acquired the original shareholders' 100% equity interest in Beijing Helitong; (iv) Clear Mind, a BVI company which acquired the original shareholders' 100% equity interest in World Hope. Through this series of ownership arrangement, we obtained the 74.11% legal ownership of Beijing Hollysys instead of through consignment agreements. However, there can be no assurance that the PRC authorities will not, in the future, challenge the appropriateness of the procedures of the transferring of the ownership of the PRC subsidiaries as the Company did not directly go through the procedures required by the M&A Regulations.

On July 1, 2009, the Company completed the acquisition of 1.78% equity interest in Beijing HollySys from the non-controlling interest holder for a consideration of RMB 18 million (approximately \$2,638,793), and held 75.89% equity interest of Beijing HollySys upon the completion of the acquisition.

On December 23, 2009, we entered into a share sale and purchase agreement, or the Share Purchase Agreement, with Unionway Resources Limited, a business company incorporated in the BVI, or the Seller, pursuant to which, among other things, the Company acquired 100% equity interest in Maypower Limited, a business company incorporated in the BVI and owned 24.11% of Beijing Hollysys. As the consideration for the acquisition of the equity interest, we agreed to:

- 1) issue 4,413,948 ordinary shares, or the Shares, to the Seller, and
- 2) pay cash \$9,917,062.5, or RMB 67,634,366.25 to the Seller.

The Shares were issued to the Seller and its designee on March 16, 2010. As a result of the acquisition of the equity interest, we indirectly own 100% of Beijing Hollysys.

On September 1, 2009, Beijing Hollysys entered into an agreement with two equity owners of Beijing WoDeWeiYe to acquire 51% equity interest in of Beijing WoDeWeiYe for a cash consideration of RMB 2 million (approximately \$294,477). Upon the acquisition, Beijing WoDeWeiYe became a subsidiary of the Company, and the operating result of Beijing WoDeWeiYe was included in the Hollysys's consolidated financial statements effective from September 1, 2009. We acquired Beijing WoDeWeiYe to engage in the intelligent electric meter business and to further build up our foothold in subway automation sector.

On June 4, 2010, Beijing Hollysys S&T invested RMB 10 million (approximately \$1,464,536) to establish a wholly owned subsidiary, Beijing Hollysys Electronics, which engages in the business of automation equipment manufacturing and assembly.

On June 4, 2010, Beijing Hollysys S&T invested RMB 5.10 million (approximately \$746,913) to establish a subsidiary, Beijing Hollycon, which engages in the medical automation equipment manufacturing business.

On March 9, 2011, Beijing Hollysys invested RMB 10 million (approximately \$1,520,751) to establish a subsidiary, Xi'an Hollysys Co., Ltd, which engages in the research and development business.

On April 15, 2011, Beijing Hollysys S&T invested RMB 10 million (approximately \$1,528,585) to establish a subsidiary, Hollysys (Beijing) Investment Co., Ltd., which engages in the investment management and consulting business.

Singapore Hollysys

On November 19, 2007, we entered into a sales and purchase agreement with Fulbond Systems Pte. Ltd., or Fulbond Systems, a Singapore based company partially owned by Mr. Kiam Fee Yau, an ex-director of ours, to acquire a 100% interest of Fulbond Systems for a price of SGD\$1,066,234 (approximately \$744,596). Pursuant to the sales and purchase agreement, the closing day of this acquisition was November 30, 2007 and after the ownership transfer, we changed the name of Fulbond Systems to “Hollysys (Asia Pacific) Pte. Limited,” or Singapore Hollysys. The purchase price was paid in cash on December 11, 2007. As a result of the transaction, Singapore Hollysys becomes our wholly owned subsidiary and the operating results of Singapore Hollysys is included in our consolidated financial statements, effective from December 1, 2007. We acquired Singapore Hollysys to serve as our Asia Pacific headquarters to market our automation products within the region as well as in other overseas countries.

On May 18, 2011, we entered into a stock purchase agreement with Concord Corporation Pte. Ltd., or Concord, a Singapore headquartered electrification related service provider to rail and industrials in South-East Asia and the Middle East, to acquire a 100% interest of Concord Corporation Pte. Ltd., Concord Electrical Pte. Ltd., and Concord Electrical Sdn. Bhd. incorporated in Malasia (Concord Group), for a combination of cash and stock valued at approximately \$43.2 million. The cash portion of purchase price was paid in two equal installments of 20.75 million Singaporean dollars (approximately \$16.9 million) each in May 2011 and July 2011 respectively. The deal was closed on July 1, 2011, and approximately one million ordinary shares of Hollysys with a value of approximately \$9.4 million were issued in September 2011. As a result of the transaction, Concord and its related companies became our wholly owned subsidiaries and the operation results will be included in our consolidated financial statements, effective from July 1, 2011.

B. Business Overview

We are a leading provider of automation and control technologies and applications in China that enable our diversified industry and utility customers to improve operating safety, reliability, and efficiency. Founded in 1993, we have approximately 3,100 employees with nationwide presence in over 40 cities in China and subsidiaries and offices in Singapore and the Middle East. We serve over 2000 customers in the industrial, railway, subway and nuclear industries in China, and South-East Asia. Our proprietary technologies are applied in the industrial automation solution suite, including the Distributed Control System (DCS), Programmable Logic Controller (PLC), RMIS, HAMS, OTS, and other products, high-speed railway signaling system of the Train Control Center (TCC) and Automatic Train Protection (ATP), and other products for surface railway networks, subway supervisory and control platform (SCADA), and nuclear conventional island automation and control system.

We have historically focused our efforts in the area of DCS, which are networks of controllers, sensors, actuators and other devices that can be programmed to control outputs based on input conditions and/or algorithms, that are mainly used to control continuous manufacturing processes. Our DCS have been widely used in the industries involving continuous flow of material handling, such as power generation, petro-chemical, chemical, cement manufacturing, paper mills, and waste water recycling. We have also entered the PLC market, which is mainly used in discreet control applied to a wide array of industries. PLCs are usually integrated together into machines providing control at the machinery level. With more of our proprietary products introduced into the market and the behavioral change of customers' purchasing practice, we gradually have changed our market and sales positioning from being a single DCS/PLC product provider, to being a total solution provider encompassing third-party hardware-centric products such as instrumentation and actuators, our proprietary DCS/PLC products, and valued-added software packages such as AMS (asset management system), MES (manufacturing execution system), APC (advanced process control system), OTS Simulation, RPO Control Optimization, and Remote Monitoring. The safety system, currently in development, is expected to be certified under European safety standards and will be introduced to the market in 2012, to further round out our proprietary product suite in the industrial automation segment.

We also branched out from the industrial automation domain into the subway and surface rail businesses, leveraging on our core competency and strong research and development capabilities, and have already established a leading position in the high-speed rail signaling market and subway SCADA (Surveillance Control and Data Acquisition) market. We also command a position in China's nuclear automation and control market as the only proven local automation and control product provider to the conventional island of nuclear stations. Through our 50/50 joint venture with China Guangdong Nuclear Power Holdings Co., Ltd., China Techenergy Co., Ltd., we have access to all the nuclear reactors being contracted to our joint venture partner, which is currently holding roughly 60% of China's nuclear market share. We believe that our present leadership position in the high-growth segments is attributable to our vision, execution, and strong research and development capabilities.

We have a reputation in the industry for our comprehensive capabilities in the PRC domestic industrial automation market and have concentrated our focus on the development of this market. We sell our products and services to, or carry out engineering projects for, national or multi-provincial companies with subsidiaries located across 30 provinces in China. To date, we have served more than 2,000 industrial enterprise customers and have undertaken over 10,000 projects. We believe that the quality of our systems is unsurpassed by local Chinese competitors and is comparable to high-end foreign suppliers of DCS and the history of our projects supports that view. For example, after three years of review and analysis, BASF, a large multi-national company, has designated us as a potential qualified DCS vendor for the company, a distinction shared with large multinationals such as ABB and Emerson.

Our revenue increased from approximately \$121.5 million in fiscal year 2008, to approximately \$262.8 million in fiscal year 2011, representing a compounded annual growth rate (CAGR) of approximately 29% for the past three years. During the same period, our non-GAAP net income increased by CAGR of 31%. These significant increases reflect our success in exploring new business areas and our increasing market penetration. We continually seek to broaden our market reach by introducing new products and improving our profit margin through new business areas such as railway control systems and nuclear power plant control, while exploring international market to fulfill our mission of sustainable and high-growth.

Strategy

Our goal is to become one of the world's leading automation and control technology and product providers. To meet this goal we plan to enhance the core competencies that have made us a leading domestic automation and control technology and application provider in China, the only Chinese company qualified to design and manufacture control systems for conventional island of nuclear power stations, and a leader in the industrial automation and in the high-speed rail and subway sectors. The principal elements of our core business strategies are as follows:

- To further establish our leadership position as a dominant automation and control technology and application provider across all the addressable market segments – We seek to be a potential industry consolidator in China as a dominant leading provider of industrial automation and control technology and application for clients in various industries, by presenting ourselves as a more total solution provider and expanded sales force and network across the country. We seek to further penetrate the high-speed rail and subway business with more proprietary products to enhance our leading position and market share. Since the majority of our customers operate in a wide range of industries, especially in the high-speed rail, subway, and nuclear sectors, we stand to be a prime beneficiary of China's drive for environment protection, clean energy, lower carbon emission, national economic development model transformation from export oriented to domestic consumption oriented, and the rising labor cost due to demographic change in China. We plan to aggressively expand our business to fully exploit the anticipated growing demand for automation and control in areas favored by government policy and the macro trend, such as clean energy and other environmentally friendly industries, and infrastructure industries. Our combination of patented technologies, strong research and development capabilities, ability to leverage strategic alliance to enter and penetrate new market segments, and a comprehensive understanding of the Chinese market should allow us to

capitalize on these growth opportunities.

- To continuously enhance our leadership position in technology – We have long been recognized as a pioneer in the development of industrial automation and control technology and applications in China. We are continuously seeking ways to improve our existing product lines while being committed to the development of new applications, platforms, and products. In order to maintain our leadership in technology, we have devoted and will continue to devote significant resources to the research and development that is undertaken by a group of highly trained and skilled engineers. We plan to concentrate our research and development resources on our addressable market related technologies and products, and international market, including the 5th generation of proprietary DCS platform, subway signaling system, safety system for industrial automation, and high-speed rail products to complement our existing high-speed product portfolio.
- To actively explore and prepare for international market expansion– Management is pursuing a strategy for Hollysys to have meaningful revenue generated from the international market and to become one of the leading automation and control players in the world. We made significant progress in this business objective through the acquisition of the Concord Group, headquartered in Singapore, through which we obtained a well-established distribution channel and customer/partner base to cross-sell our products in the rail and industrial automation segments and a seasoned management team to form the core of our future international team. Because the Ministry of Railways of China employs its own administrative admission system to allow or disallow use of products and entry of system providers to supply the China’s national rail industry, our high-speed rail signaling products that are currently deployed in China’s high-speed rail lines have not needed and have not European safety standard certification, which is a prerequisite for the rail market outside of China. To satisfy international requirements, we plan on redesigning the whole set of our signal systems, based wholly on our own proprietary technologies, with the goal of obtaining full certification by European organizations for the SIL 4 certification (Safety Level IV). The signaling system set includes the onboard ATP (automatic train protection) system with SIL 4 certification for high-speed rail and subway that are used to protect the train from travelling at excessive speeds, the ground based TCC (train control center) with SIL 4 certification for ground safety control of trains, the CBI (computer based interlocking) system with SIL 4 certification for both high speed rail and subways, the ATS (automatic train supervision) system with SIL 2 certification for metro ATC systems, and other auxiliary interfacing products. Based on our own technologies, we are able to customize our system platforms to meet every level of requirements from conventional rail signaling systems to the most state-of-the-art, high-speed rail applications, not only for the Chinese market but also for the international market. We already have our proprietary ATP and LEU (line side unit) certified under SIL4 standards. Our current schedule is that most of the platform will be certified by the calendar 2011 year-end, and ATP for metro systems with ATO (automatic train operation) will be certified by the end of calendar year 2012.

Products and Services

As a leading provider of automation and control technology and applications in China, we provide our customers with our standard and customized products and corresponding services based on each client’s specific requirements. We are committed to providing reliable, advanced and cost-effective solutions to help customers optimize their processes to achieve higher quality, greater reliability and better productivity and profitability.

Industrial Automation: Our principal offering is a comprehensive suite of automation systems for a wide spectrum of industrial market clientele, ranging from petrochemical, thermal power industries, to cement production and paper making industries. Our comprehensive suite of automation solution consists of third-party hardware-centric products such as instrumentation and actuators, our proprietary software-centric DCS/PLC, and valued-added software packages such as AMS (asset management system), MES (manufacturing execution system), APC (advanced process control system), OTS Simulation, RPO Control Optimization, and Remote Monitoring. The safety system or emergency shut-down system, currently in development, is expected to be certified under European safety standards and be introduced to the market in 2012, to further round out our proprietary product suite in the industrial automation segment. The two mainstream products for this market segment are our DCS products and our PLC. DCS are a network of controllers, sensors, actuators and other devices that can be programmed to control outputs based on input conditions through logic calculations. In an automated production line, sensors or so-called “instrumentations” are distributed across the production facility to monitor sub-systems like the robots, CNC machines, and logistic tools. These sensors are like human eyes, which monitor the process, and detect any abnormal situations. The information collected from those sensors is then transmitted to the DCS for centralized data processing through communication networks. The central computer (brain) processes information and generates commands, based on sophisticated algorithmic and pre-set parameters. These commands are then sent to actuators (muscles/bones) through communication devices to execute the orders and maintain production flow. PLCs are small computer devices installed on machines or equipment, for example, on a factory assembly line, for manufacturing automation.

High-speed Rail: Over the years, Hollysys has successfully scaled its automation application from industrial manufacturing to rail and subway industry, with proprietary product lines including, TCC (Train Control Center) and ATP (Automation Train Protection). An ATP essentially acts as the train over-speed protection mechanism, which collects real-time information like speed limit ahead, train operation status, line data, instructions from train control center, then combines that information with the train parameters to produce train protection curves. In case of any human errors, like driver’s negligence at the red light, it applies emergency brakes automatically. TCCs are an on-ground control center at railway stations or equipment stations which monitors route condition, track status, train schedules, distance between trains, and the working status of other essential function devices, and then through logic calculation, generates control instructions and commands. The command information from the TCC is then transmitted to the ATP located on the locomotives/trains, through track circuits and electronic beacons located at various points along the railway line, or wireless.

Nuclear Automation and Control: As the only proven domestic automation control systems provider to the nuclear power industry in China, we provide our HOLLiAS NMS product to China’s nuclear power industry. In a nuclear station, the nuclear island operates to transform nuclear energy to heat energy, and pass on the steam generated by the steam generator to the conventional island, where steam drives the turbine to generate the electricity, and pass on to the transformer for loading onto the grid. Our HOLLiAS NMS proprietary control systems are now used in conventional islands for safety and operation control. The know-how was accumulated from our industrial DCS applications in high-end, conventional energy power plants, with much more sophisticated software and hardware specifications, and more stringent production and quality assurance process. Our nuclear joint venture China Techenergy Co., Ltd. has already successfully completed developing its proprietary nuclear island automation and control system, which is expected to be commercialized in 2012 or 2013, when the total automation and control for nuclear power stations will be fully localized for China.

Subway Automation: We have provided our SCADA system to China’s subway market for many years, including the Beijing Subway, Shanghai Metro, Guangzhou Metro, and Shenzhen Metro. SCADA is an open software platform to enable integrated and unified monitoring of all necessary sub-systems of the subway, including the Power Supervisory Control and Data Acquisition System, Building Automatic System, Fire Alarm System, Platform Screen Door System, Access Control System, Closed Circuit Television, Passenger Information System, Passenger Train Information System, and Alarm System. Given the exponential growth in China’s subway market and the continued growth

expected for the decades to come, Hollysys is developing its proprietary Subway Signaling System, based on its strong research and development capability and technical know-how of signaling application accumulated from high-speed rail. The current subway signaling market is predominantly occupied by multi-national corporations, such as Siemens.

We establish a project group for each potential customer, which has a team of systems engineers and managers to provide total integrated solutions to our customers to meet their specific requirements. Each project group is staffed with a dedicated team of sales engineers, technical engineers and project management professionals. The sales engineers and technical engineers work together to offer the best customized solutions as a result of their understanding of the customer's detailed requirements through on-site studies. The technical engineers are responsible for hardware assembly, software configuration, testing and installation, commissioning and trial operation, and start-up and training; while the project management professionals oversee budgetary matters, coordinate the work force, ensure adequacy of resources and monitor progress and quality to ensure the timely completion of each project. Our integrated solutions projects involve one or more of the following activities:

- **Solution planning** – We provide our customers with strategic and tactical reviews of their current operations and future requirements. We do much of this work before the customer awards the contract to assist the customer in developing an appropriate request for proposal and to improve Hollysys' chances of winning the contract. The planning includes defining client business requirements, developing appropriate hardware and software, and selecting preferred technology.
- **Solution design** – We detail the industry specifications and implementation tactics necessary to achieve our customer's objectives. Hollysys also considers how the new technology will integrate hardware and software integrated in the solution with the customer's existing hardware and software and how it will be managed on an ongoing basis. Examples of these services include defining functional requirements for the system and our components, developing integration plans and designing of customer-specific system and services applications.
- **Solution implementation** – We install the recommended systems to meet our customers' specific requirements. Key activities include project management, hardware procurement and production, software development, configuration and field installation and testing, and development of customized system and services management applications.
- **Maintenance and support services** – We emphasize creating value for our clients by providing high quality tailored services. Our professional, prompt and long-term services include technical services, engineering services to specific industries, application development services and maintenance services. We provide maintenance and technical support in connection with all of our systems integration projects. These services currently include assistance with the implementation of new system platforms, configuration and programming services for new business processes, and assistance with technology upgrading. We believe that our policy of on-going maintenance and technical support will help foster long-term relationships with our customers and eventually create significant business opportunities.
- **Training** – We also incorporate customer training and an ongoing service component into our product offerings. We provide technical training for our customers and strategic partners to increase their awareness and knowledge of DCS technologies in the Chinese industrial automation market and to support the operations of our customers' integrated automation systems. The training helps to ensure that customers derive the greatest amount of benefit possible from their new automation system. As a result, this training leads to increased value, which in turn generates customer satisfaction and loyalty.

Our integrated solutions based on our proprietary technology and products create value for and improve the competitive strengths of our customers by:

- **Generating synergy and improving efficiency of our customers through integrating communications, marketing and service functions;**

- Utilizing our industry and process knowledge to develop customized solutions that improve the efficiency of our customers;
- Providing a software platform for the optimization of management operations, which provides real-time automation and information solutions throughout a business; and
- Offering maintenance and training services to our customers, which help to cut costs and improve operating efficiency.

We customize our floor plans based on careful on-site studies, build design-specific network systems using our advanced DCS technology and proprietary software, and offer manufacturing execution system services to ensure that real-time management control is available to our customers in a streamlined and easy-to-use manner.

We believe that our product design and applications that are integrated in the solutions are unmatched among our domestic competitors. We also believe that the sophistication and quality of our products rival those of the multi-national automation and control product suppliers, while our ability to understand and meet the needs of our Chinese customers gives it a leading edge over foreign competitors. The value of this combination is reflected in our strong revenue and profit growth over the years.

Market for Automation and Controls Solutions

DCS Market

According to the ARC Advisory Group, or ARC, an industry research group, the DCS market in China, as measured by revenue, exceeded \$780 million in 2005 and will grow at a compounded annual growth rate of approximately 12% through 2010. ARC further projects that the DCS market, as measured by revenue, will exceed \$1,400 million by 2010. The chart below shows the forecast of the DCS market size in China.

Source: ARC Advisory Group

We agree with ARC's assessment that, "China, in contrast to most other countries, provides robust growth prospects for the DCS suppliers. With new investments continuing to take place in its core process industry sector, the market has excellent growth potential in both the near and long-term. Almost a quarter of a billion people with their growing disposable income are generating an exploding demand for a wide range of products. Domestic and global manufacturers, lured by this opportunity, have created new, world-class production facilities in almost all vertical industries. They are going beyond the near term opportunity for obtaining low cost labor. They are pursuing the best available control system technology and attaining a sustainable competitive advantage."

Currently, the vast majority of the global automation market is still controlled by a handful of multi-national companies, most of them with western roots. Our competition includes some very recognizable names: Honeywell (US); Siemens (Germany); Emerson (US); ABB (Sweden); Rockwell (US); Westinghouse (US); and Hitachi (Japan). The western roots of automation are not surprising, as that is also where industrialization began and progressed the farthest during the 19th and 20th centuries. However, a new focus of the automation market is China, where the tremendous growth in industrialization is by now a very familiar story. Manufacturing jobs in the US and other western economies over the past two decades have steadily decreased, while China's industrial base has expanded at the rate of 8.5% annually since 1991. China's shift from a developing country to one of the world's leading manufacturers of industrial equipment and consumer goods has created a substantial and growing demand for the automation systems that help to make those manufacturing processes more efficient, reliable and safe.

From 2000 to 2008, the global automation industry grew, as measured by revenue, by about 4.5%, according to a research report by J.P.Morgan. We believe China's industrial automation growth rate is far greater than this world average growth rate, in which we see PLC enjoying a more healthy growth rate than DCS given its relative lower penetration rate and the rising cost of labor. In the industrial side of our business, our current market share is 10.6%, which was measured by industrial customer brand name usage, from a third party report. To date, we have implemented over 8,000 projects, with over 2,000 customers. The client base for this segment includes large state-owned enterprises, multi-national companies, and other domestic companies. Our main competitors in this field are global players such as ABB, Siemens, and Emerson, as well as Supcon from China. We believe that the Hollysys brand recognition and market reputation and our strong research and development capabilities will enable us to enter and penetrate high-margin market segments currently dominated by foreign companies, and will ensure our revenue from this industrial market to grow at a rate continuously exceeding the industry average.

High-Speed Rail and Subway Market

Another promising end-market for Hollysys is the high-speed rail market in China, where we command a leading position in providing high-speed rail signaling systems to ensure the safety of passenger train movement. High-speed rail is a relatively new development in China. The Ministry of Railways of China developed China national high-speed rail signaling technological standard, the China Train Control System, or the CTCS. Under the CTCS, the standard governing 200-250km/hour speed category is called C2, while C3 is governing the 300-350km/hour category. These standards are different from the international standards propounded by European organizations or Japan. There are more than 8,000km of high-speed rail tracks in operation in China, with more than 17,000 km high-speed rail tracks in construction, according to the Ministry of Railways. The majority of operational high-speed lines are in 200-250km/hour, with only a few operational lines in 300-350km/hour, which include Beijing-Shanghai line, Wuhan-Guangzhou line, Zhengzhou-Xian line, Shanghai-Nanjing line, and Shanghai-Hangzhou line, of which the Zhengzhou-Xian line was supplied by Hollysys. We have also entered into contracts to provide signaling systems for another line in C3 category, the Guangzhou-Shenzhen line, which is under construction.

According to the official announcement from the Ministry of Railways, China is planning to have 45,000 kilometers of high-speed railways in operation by the end of 2015, with an estimated capital budget of approximately 2.8 trillion RMB, far increasing the current capacity of total high-speed railway kilometers of 11,345 kilometers operating in 16 countries around the world. According to China's Ministry of Railways, the China's high-speed rail network will consist of artery lines and inter-city lines. The artery lines are "the Four Horizontals and the Four Verticals" referring to their positions on the map of China. The Four Vertical lines include the Beijing-Guangzhou line, Beijing-Shanghai line, Harbin-Dalian-Shenyang-Beijing line, and Shanghai-Hangzhou-Shenzhen line. The Four Horizontal lines include the Lanzhou-Xian-Zhengzhou-Lianyungang line, Shanghai-Wuhan-Chongqing-Chengdu line, Hangzhou-Changsha-Kunming line, and Taiyuan-Shijiazhuang-Qingdao line. The inter-city high-speed lines are mainly planned for economically well-developed regions with high densities of population, such as Zhu Jiang River Delta (Guangzhou-Shenzhen region), Yangtze River Delta (Shanghai-Hangzhou region), and Beijing-Tianjin-Tangshan region. As one of the three high-speed rail signaling products providers admitted by the Ministry of Railways in the C2 category, and one of the only two high-speed rail signaling products providers to the C3 segment, we believe that Hollysys is well positioned to benefit from this unprecedented, world leading high-speed railway build-out.

We also provide our proprietary software platform and solutions of SCADA to subway market. China subway market is expected to receive significant government investment due to urbanization and environmental concerns. According to China's Ministry of Housing and Urban-Rural Development, the China subway market will grow from 776 kilometers in 2008 to 4,189 kilometers in 2015, with government estimated investment amounting to \$129 billion in the period. Leveraging on our know-how from high-speed surface rail signaling technology and our well-recognized brand name, we are developing our proprietary signaling products for the subway market, and hoping to replace foreign platforms currently dominating the China's subway signaling market. We believe it will present a better value positioning to our subway customers by bundling our proprietary subway SCADA system with our proprietary signaling system, when we will see our market share and margin expansion.

Nuclear Market

We are well-positioned to benefit from China's nuclear build-out. At present, China's nuclear power sector is relatively underdeveloped, with the vast majority of power generated by coal-fired power plants. There are currently 11 nuclear stations in operation, providing approximately 9 GW of power, in comparison to the total electricity-generating capacity in China of approximately 700 GW. This represents approximately 1.3% of the total electricity generated by nuclear energy, lagging far behind the world average of 15% power generated from the nuclear energy, with France being the highest with 70% of its power generated from nuclear.

Driven by clean energy initiatives and China's commitment of reducing its carbon emission by 45% per GDP unit by 2020, China's installed nuclear power generating capacity is expected to reach 100 GW by 2020. Approximately, it is believed that one nuclear reactor generates 1GW electricity. During the fiscal year 2010, we formed a 50/50 joint venture, China Techenergy Co., Ltd., with China's leading nuclear station operator, China Guangdong Nuclear Power Holdings Co., Ltd., to provide its proprietary non-safety automation and control products to the nuclear stations constructed by China Guangdong Nuclear Power Holdings Corporation. We believe this strategic alliance position us to be the dominant nuclear automation system provider in China. China Guangdong Nuclear Power Holdings Co., Ltd. currently has approximately 60% of China's nuclear market share.

Integrated Contracts

The main channel through which we get our automation system business is the bidding process. Customers seeking bids propose their requirements and specifications in legal bidding documents and those companies that are interested in obtaining these contracts make a bid in written form. If we win the bidding, we get the integrated contract. We

derive over 90% of our total consolidated revenues, mainly from the integrated contracts that we win through the bidding process. In addition, we gain another revenue stream through the sale of spare parts and component products to customers for maintenance and replacement purposes after the completion of the integrated solution contract, which is in essence a recurring revenue stream to us, even though it is not in the form of multiple-year contract.

The purpose of an integrated contract is to furnish an automation system that provides the customer with a total solution for the automation or process control requirement being addressed. The automation system and total solution that we offer consists of hardware, software and services, all of which are customized to meet the particular needs and technical specifications of our customers. None of hardware, software and service has independent functionality, and therefore cannot be sold separately to customers.

The major terms of an integrated solution contract include solution planning and design, system installation, customer acceptance, payment milestones and warranty. The process of fulfilling an integrated contract consists of the following four stages:

- Solution planning and design - We provide customers with a customized plan for achieving the required solution by establishing a project group for each contract. The project group includes system engineers who propose and discuss and agree on the system design and implementation plan with the technical personnel of the customers.
- System manufacturing and installation - Based on the design and implementation plan, and in accordance with the project schedule, we enter into the process of purchasing the necessary hardware, manufacturing components for the hardware, developing software platform, re-configuring the software embedded in the hardware, and fabricating the integrated hardware into cabinets, on-site installation and testing, and training customer's personnel about how to use the automation and total solution.
- Customer acceptance - The procedures for customer inspection and acceptance of the system are typically contained in the contracts. The initial inspection usually occurs when the hardware is delivered to the customer's site for the purpose of detecting any obvious physical damage during shipping and to confirm that the entire order was delivered. A final acceptance will be performed upon the satisfaction of integrated solution testing.
- Warranty period - The integrated solution contracts customarily provide our customers with a one-year warranty (although sometimes the warranty period may be two years per the customers' requests), which runs from the date of the final customer acceptance. The end of warranty period represents fulfillment of the entire contract.

Because of the nature of customized integrated contracts, a customer does not have the right to return the products that we deliver, so long as such products conform and perform to the customer's specification. Prior to delivering our products to a customer's site, we perform an internal test to ensure that the automation system works as intended. After installing the products on a customer's site, any problems are solved during trial runs. Once the testing requirements have been satisfied, a customer will sign and date a customer acceptance document, which begins the warranty period. Due to the nature of this process, many companies in the automation systems business generally do not carry product liability insurance.

The size of an integrated contract is determined by a customer's needs in terms of the amount of equipment needed and the complexity of integrated solution. The size of an integrated contract drives the revenues generated by the contract. Because certain contracts will require working periods longer than one year, the best way to measure the contract revenue realized is to use the percentage-of-completion method. Ultimately, our revenue stream will be driven by the average price of an integrated contract and how many integrated contracts have started in each reporting period.

Our backlog of contracts presents the amount of unrealized revenue to be earned from the contracts that we have won. Accordingly, any increase or decrease in new contracts won by us, or any change of scheduled delivery dates will have a future impact on our future revenue streams. In the event of a delay of delivery schedule, then the time of inspection, installation, trial run and customer acceptance will be delayed accordingly, all of which will affect our revenue recognition. If the delay of delivering the specified automation systems was a result of our inability to deliver the system on a timely basis, then we will be held responsible for this delay, in accordance with the terms specified in the respective integrated contracts.

Competition

We compete with various domestic and international corporations offering automation systems to the Chinese industrial automation market. We believe that our proprietary technology and products provide us with a strong competitive advantage over our domestic Chinese competitors. However, a number of multinational companies, some of whom have substantially greater financial and other resources than we currently have, have been offering first rate automation systems to Chinese customers in competition with us. We believe that our primary competitors in the industrial automation market for our products are multi-national corporations, such as ABB, Honeywell, Emerson and Siemens, and the local company Supcon, a private company affiliated with Zhengjiang University.

In the high-speed rail business, as China's Ministry of Railways employs an administrative admission system and China establishes its national rail technology standard, the China Train Control Standard (CTCS), we believe that competition from multi-national companies will decrease or be eliminated. Currently, Hollysys is one of only three entities granted admission to supply signaling products to China's 200-250km/h segment of the high-speed rail market. The other two are the China Rail Signal & Communication Corp. (CRSC) and the China Academy of Railway Science. Hollysys is one of the only two permitted signaling product providers to China's 300-350km/h segment of the high-speed rail market. The other provider is CRSC. In subway business and the SCADA market, we mainly compete with Nanjing Automation Research Institute (NARI). In nuclear automation segment, we mainly compete with multi-national corporations such as Siemens, Areva, and Invensys.

When compared to our competitors, apart from satisfying certain China based criteria, we believe that our key competitive edge is the provision of better value for money to our customers with the following distinctive attributes:

- **Emphasis on Engineering.** Engineers are a critical element of effective design of both hardware and software components of automation equipment and systems. For western companies, they are also a very costly element of the process. Even the largest western companies face constraints in the size of their engineering staff due to the high salaries and attendant costs. One of our competitive advantages is the lower cost of engineers in China relative to those in the Western nations. Applying high levels of engineering effort to each product enables us to provide a solution that is tailored not only to the industry in which the customer operates, but also to the customer's specific needs. That custom solution is provided at a cost that is typically lower than the generic products of our competitors.
- **Industry Process Knowledge.** We devote substantial time and effort to understanding our customers and their business. This knowledge helps to ensure that the systems we design will provide the optimum in benefits for our customers. We maintain this information in an extensive "library" of industry process information that we utilize to speed up the system design process and to maximize the quality of the result, while at the same time minimizing costs. As a result, we were able to take into account the widely varying degrees of sophistication and resources that our Chinese customers possess. The result of this strategy is to broaden our potential customer base and to consistently deliver products that are of value to these customers.

- **Integration Services.** Western automation system companies are principally system platform suppliers and the role of integrating the systems into the customer's overall management information system is generally left to independent firms. While such firms are widespread in western countries, China does not have a large number of systems integration companies to perform this work, as these companies have been historically unprofitable in China. We have bridged this gap by providing a vertically integrated solution to our customers that includes the integration of our hardware into the customers' overall manufacturing and information systems. This combination of the two aspects of system design and installation take further advantage of the low cost of engineering services in China and provides another benefit, as the design and integration teams can work together to produce the best result more quickly and efficiently, again lowering costs.
- **Core Technologies.** Although we deliver tailored systems, our systems are based on basic modules of automation technology that are common across a broad array of industries and applications. Using these modules as a starting point, development of an industry and customer-specific product is both more efficient and produces a better result than starting from scratch each time. That means that, with our labor cost advantages, we can provide a highly customized automation product at a very favorable cost.