

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

TABLE OF CONTENTS

	Page
PART I	
ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS	1
ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE	1
ITEM 3. KEY INFORMATION	1
ITEM 4. INFORMATION ON THE COMPANY	19
ITEM 4A. UNRESOLVED STAFF COMMENTS	36
ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS	36
ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES	58
ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS	66
ITEM 8. FINANCIAL INFORMATION	68
ITEM 9. THE OFFER AND LISTING	69
ITEM 10. ADDITIONAL INFORMATION	71
ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	84
ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES	84
PART II	
ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES	85
ITEM 14.	85

MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITIES HOLDERS AND USE OF PROCEEDS		
ITEM 15T.	CONTROLS AND PROCEDURES	85
ITEM 16A.	AUDIT COMMITTEE FINANCIAL EXPERT	88
ITEM 16B.	CODE OF ETHICS	88
ITEM 16C.	PRINCIPAL ACCOUNTANT FEES AND SERVICES	88
ITEM 16D.	EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES	89
ITEM 16E.	PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS	89
ITEM 16F.	CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT	89
ITEM 16G.	CORPORATE GOVERNANCE	89
PART III		
ITEM 17.	FINANCIAL STATEMENTS	89
ITEM 18.	FINANCIAL STATEMENTS	89
ITEM 19.	EXHIBITS	89

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 Hollysys 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