Hollysys Automation Technologies, Ltd.
Form 20-F
September 30, 2009

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, 2009

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 _________________________

For the transition period from ___________ to ___________.

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)

10 Jiancaicheng Middle Road
Xisanqi, Haidian District
Beijing, People's Republic of China, 100096

(Address of principal executive offices)

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

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 common stock as of the close of the period covered by the annual report (June 30, 2009): 41,942,61 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   x 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   x 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.
xYes ¨ 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). o Yes o 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 x

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

U.S. GAAP x	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).
oYes x No

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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 Hollysys" are references to Beijing Hollysys Co., Ltd.;
- "Beijing Hollysys S&T" are references to Beijing Hollysys S&T 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;
- "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 Automati Technologies Ltd., a British Virgin Islands company, and its wholly-owned subsidiaries, Singapore Hollysys and Gifted Time; Gifted Time's 60% majority-owned subsidiary, Hangzhou Hollysys; Gifted Time's wholly-owned subsidiary, Clear Mind; Clear Mind's wholly-owned subsidiary, World Hope; World Hope's wholly-owned Chinese operating subsidiary, Beijing Helitong; Beijing Helitong's wholly-owned operating subsidiary, Beijing Jin Qiao; Beijing Jin Qiao's 74.11% majority-owned subsidiary, Beijing Hollysys; Beijing Jin Qiao's wholly-owned Chinese operating subsidiary, Hollysys Automation; and Beijing Hollysys' 70% majority-owned subsidiary, Beijing Haotong;
- "Hollysys Automation" are references to Beijing Hollysys Automation & Drive 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; and
- "World Hope" are references to World Hope Enterprises Limited, a Hong Kong company.

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", " 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, a general economic downturn, a downturn in 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 underlying assumptions 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

Selected Consolidated Financial Data

The following table presents selected financial data regarding our business. It should be read in conjunction with our consolidated and unconsolidated 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 income data for the fiscal years ended June 30, 2009, 2008 and 2007 and the consolidated balance sheet data as of June 30, 2009 and 2008 have been derived from the audited consolidated financial statements of Hollysys that are included in this annual report beginning on page F-1.

The audited consolidated financial statements for the years ended June 30, 2009, 2008 and 2007 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,		
	2009	2008	2007
Statement of Income Data			
Revenue	157,502,067	121,498,752	101,885,486
Operating income (loss)	(7,310,502)	2,685,309	21,525,875
Income (loss) before income taxes	(5,603,121)	2,248,419	18,646,368
Net income (loss)(1)	(13,851,064)	(1,677,178)	13,084,751
Add: Amortization of discount and interest on notes payable related to bridge loan	-	3,244,434	6,401,975
Stock-based compensation cost for incentive shares	39,240,000	17,000,000	-
Stock-based compensation cost for options	319,026	84,473	-
Non-GAAP net income	25,707,962	18,651,729	19,486,726
Weighted average common shares	44,950,883	37,658,437	22,200,000
Weighted average number of diluted common shares	44,950,883	37,658,437	22,883,836
Basic earnings per share(1)	(0.31)	(0.04)	0.59
Diluted earnings per share(1)	(0.31)	(0.04)	0.57
Non-GAAP basic earnings per share	0.57	0.50	0.88
Non-GAAP diluted earnings per share	0.57	0.50	0.85
Cash dividends declared per share	-	-	0.03
Balance Sheet Data			

Total current assets	283,971,473	214,320,514	128,404,729
Total assets	345,443,522	252,734,095	154,930,570
Total current liabilities	101,121,574	71,028,772	101,419,000
Total liabilities	149,424,388	87,794,820	104,703,288
Minority Interest	22,479,241	17,645,377	13,200,169
Stockholders' equity	173,539,893	147,293,898	37,027,113

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

Exchange Rate Information

The conversion of RMB into U.S. dollars in this annual report is based on the noon buying rate in the city of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, the rates stated below, or at all. The PRC government imposes controls over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign exchange and through restrictions on foreign trade.

The following table sets forth various information concerning exchange rates between the RMB and the U.S. dollar for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this annual report or will use in the preparation of our periodic reports or any other information to be provided to you. The source of these rates is the Federal Reserve Bank of New York. As of September 18, 2009, the noon buying rate was RMB 6.8270 to US$1.00.

	Noon Buying Rate			
Renminbi per U.S. Dollar	Average(2)	High	Low	Period-end
2005 (1)	8.2766	8.2770	8.2764	8.2765
2006 (1)	8.0570	8.2765	7.9943	7.9943
2007 (1)	7.7960	8.0018	7.6120	7.6120
2008 (1)	7.2375	7.6181	6.8591	6.8591
2009 (1)	6.5738	6.8842	6.7800	6.8302
March 2009	6.8360	6.8438	6.8240	6.8329
April 2009	6.8306	6.8361	6.8180	6.8180
May 2009	6.8235	6.8326	6.8176	6.8278
June 2009	6.8334	6.8371	6.8264	6.8302
July 2009	6.8317	6.8342	6.8300	6.8319
August 2009	6.8323	6.8358	6.8299	6.8299
September 2009 (through September 18, 2009)	6.3405	6.8303	6.8247	6.8270

(1)All periods end June 30 of the stated year.

(2)Averages for a period are calculated by using the average of the exchange rates on the end of each month during the period. Monthly averages are calculated by using the average of the daily rates during the relevant period.

Capitalization and Indebtedness

Not applicable.

Reasons for the Offer and Use of Proceeds

Not applicable.

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, 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 even 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; and
- Expansion of manufacturing capacity.

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 its 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 heavily on securing a steady stream of new customers.

Our average contract is worth approximately $100,000. 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.

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

One of the competitive advantages that we enjoy is the relatively low cost of our engineering staff compared to those of our Western and Japan-based competitors. The plentiful supply of affordable engineering talent in China is a key element of our overall business strategy. However, if the available supply of engineers were to be absorbed by competing demands, 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 18 PRC utility patents that relate to various product configurations and product components and have 20 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 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, or DCS to industrial and manufacturing companies, our plans for growth include an increasing emphasis on railroad 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 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 were unable to do so, our revenues and profits would decline, resulting in a decreased value of our stock.

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 has 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. However, we have plans to enter international markets in the near future. While the manner in which we plan to do so will likely not involve large expenditures of capital and resources, it will also require 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, causing the operating results in our principal market 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."

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

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, or SOX 404, the Securities and Exchange Commission, or 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, including Form 20-F. In addition, the independent registered public accounting firm auditing a company's financial statements must also attest to and report on the effectiveness of the company's internal controls over financial reporting. Under current law, we are required to include a management report beginning with our annual report for the 2009 fiscal year and to include our independent registered public accounting firm's attestation report beginning with our annual report for the 2010 fiscal year. Our management may conclude that our internal controls over our financial reporting are not effective. Even if our management concludes that our internal controls over financial reporting are effective, our independent registered public accounting firm may issue a report that is qualified if it is not satisfied with our controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us.

We can provide no assurance that we will be in compliance with all of the requirements imposed by SOX 404 or that we will receive a positive attestation from our independent auditors. 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 recent 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, 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 merger and acquisition 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.

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 Renminbi 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 Renminbi. 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.

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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.

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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 Renminbi. The Chinese government imposes controls on the convertibility of Renminbi into foreign currencies and, in certain cases, the remittance of currency out of China. Renminbi 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 Renminbi 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 only 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.

All of our operations are conducted in China and all 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.

Controversies affecting China's trade with the United States could depress the price of our securities.

While China has been granted permanent most favored nation trade status in the United States through its entry into the World Trade Organization, controversies and trade disagreements between the United States and China may arise that depress our the price of our securities. Political or trade friction between the United States and China, whether or not actually affecting our business, could also materially and adversely affect the prevailing market price of our securities.

There can be no guarantee that China will comply with the membership requirements of the World Trade Organization, which could leave us subject to retaliatory actions by other governments and reduce our ability to sell our products internationally.

China has agreed that foreign companies will be allowed to import most products into any part of China. In the sensitive area of intellectual property rights, China has agreed to implement the trade-related intellectual property agreement of the Uruguay Round. There can be no assurances that China will implement any or all of the requirements of its membership in the World Trade Organization in a timely manner, if at all. If China does not fulfill its obligations to the World Trade Organization, we may be subject to retaliatory actions by the governments of the countries into which it sell our products, which could render its products less attractive, thus reducing revenues and profits.

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The implementation of the new PRC employment contract law and increases in the labor costs in China 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 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. As a result of the new law and regulations, our labor costs may increase. There is no assurance that disputes, work stoppages or strikes will not arise in the future. 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 are available. Therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

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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 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 common stock 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 common stock 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;
- 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 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 ending June 30, 2010, 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.

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, almost all of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons are located 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, many of whom are not residents in the United States and whose assets are located in significant part outside of the United States. 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 British Virgin Islands 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 ending June 30, 2009. 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, 2009 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.

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 North China Acquisition Corporation, or Chardan, a Delaware special purpose acquisition company, or SPAC, 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 common stock 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 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 in 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 emphasize industrial automation and integrated solutions.

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During the period from December 2007 to March 2008, Hollysys established a series of wholly owned subsidiaries, namely (i) Beijing S&T, a newly established Chinese domestic enterprise which acquired the original shareholders' 74.11% equity interest in Beijing Hollysys; (ii) Beijing Helitong, a newly established wholly foreign owned enterprise in China which acquired the original shareholders' 100% equity interest in Beijing S&T; (iii) World Hope Enterprises Limited, a newly established Hong Kong company which acquired the original shareholders' 100% equity interest in Beijing Helitong; (iv) Clear Mind Limited, a newly established BVI company which acquired the original shareholders' 100% equity interest in World Hope, and Clear Mind Limited is 100% owned by Gifted Time. Through this series of ownership arrangement, Hollysys 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 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 "Regulation of Merger and Acquisition of PRC Enterprises by Foreign Investors."

Singapore Hollysys

On November 19, 2007, Hollysys 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, one of our directors, 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 Ltd." 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.

B. Business Overview

Hollysys Automation Technologies Ltd. is a leading provider of automation and control technologies and applications in China that enables its diversified industry and utility customers to improve operating safety, reliability and efficiency. Founded in 1993, Hollysys has approximately 2,100 employees with 9 sales centers and 13 service centers in 21 cities in China, and serves over 1700 customers in the industrial, railway and nuclear industries. Its proprietary technologies are applied in product lines, including Distributed Control Systems (DCS) and Programmable Logic Controllers (PLC), high-speed railway Train Control Centers (TCC) and Automatic Train Protection (ATP), and safety control product NMS for nuclear power plants. Hollysys is the only certified domestic automation control systems provider to the nuclear industry in China. Hollysys is also one of only five automation control systems and products providers approved by China's Ministry of Railways in the 200km to 250km high-speed rail segment, and is one of only two automation control systems and products providers approved in the 300km to 350km high-speed rail segment.

We have historically focused our efforts in the area of Distributed Control Systems, or 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, with a primary concentration in power plant and chemical plant automation systems. However, we also have a significant market presence in the basic materials, pharmaceutical and food and beverage processing industries. Over the past five years, we have devoted significant resources to research and development and sales efforts for rail transportation and nuclear power segments that we believe will have the greatest growth and margin protection over the coming 10 years. 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 1,700 industrial enterprise customers and have undertaken over 8,000 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 $102 million in fiscal year 2007, to $121.5 million in fiscal year 2008 and $157.5 million in fiscal year 2009, representing a compounded annual growth rate of approximately 24.3%. 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 technology and improving our profit margin through new business areas such as railway control systems and nuclear power plant control.

Strategy

Our goal is to become one of the world's leading automation and process system companies. To meet this goal we plan to enhance the core competencies that have made us a leading domestic automation system provider in China, as reflected by our top rank among Chinese producers of DCS in 2007, the only Chinese company qualified to design and manufacture control systems for nuclear power plants, and a leader in the high-speed rail and subway sector. The principal elements of our core business strategies are as follows:

- Maintaining a leadership position in China's DCS Market – We seek to maintain and further strengthen our position in China as a leading provider of DCS platforms for clients in various industries. Since the majority of our customers operate in a wide range of process industries, especially in infrastructure industries, we stand to be a prime beneficiary of the Chinese government stimulus program of RMB 4 trillion and the macro trend of growth of China's economy. We plan to aggressively expand our business to fully exploit the anticipated growing demand for DCS products in areas favored by government spending, 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.

- Enhancing a leadership position in technology – Hollysys has long been recognized as a pioneer in the development of DCS technology as well as applications. We are continuously seeking ways to improve our existing product lines while being committed to the development of new applications. In order to maintain our leadership position in technology, we have devoted and will continue to devote significant resources to the research and development process that is undertaken by a group of highly trained and skilled engineers. We plan to concentrate our research and development resources on our core end market related technologies and products, and new upcoming growth industries, including the 5th generation of proprietary DCS platform, subway signaling system, wind energy related control products and application, and high-speed rail products to compliment our existing high-speed product portfolio.

- Expansion to Adjacent Markets – In addition to aiming for a global leadership position, our secondary goal is to carefully expand or migrate to adjacent markets that can share or strengthen our core business. We have successfully leveraged our technological foundation and strategic alliance and have expanded our end markets from industrial, to nuclear, to rail over the past 10 years. We plan to continue duplication of this successful strategy to enter some high-growth and high-margin end-markets, such as wind energy, alternative energy, and waste management.

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.

DCS Products: Our major offering is a comprehensive suite of automation systems for a wide market. Our industrial market clientele ranges from petrochemical, thermal power industries, to cement production and paper making industries, and etc. The two mainstream products for this market segment are our DCS products and our Programmable Logic Controllers, or PLCs. 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, logistic tools, etc. 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 brain processes information and generates commands, based on sophisticated algorithm 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.

TCC and ATP Products: Over the years, Hollysys has successfully scaled its automation application from industrial manufacturing to rail and subway industry, with proprietary product lines including, our Train Control Center, or TCC, product and our Automation Train Protection, or ATP, system. 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 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 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.

Nuclear Products: As the only certified domestic automation control systems provider to the nuclear power industry in China, we provide our HOLLiAS NMS product to China's nuclear power industry. A nuclear power station is identical in most respects to a normal thermal power station in the sense that steam is used to turn the turbines, which drive the generators, which is called a "conventional island." The difference is in the boiler that produces the steam, is the nuclear reactor, which is called the "nuclear island." 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 power plants, with much more sophisticated software and hardware specifications, and more stringent production and inspection process. Our safety control product for nuclear islands is currently undergoing development at our 50/50 joint venture with the leading PRC domestic nuclear operator, China Guangdong Nuclear Power Holdings Corporation.

Subway Products: We have provided our Surveillance Control and Data Acquisition (SCADA) system to China's subway market for many years, included to customers like 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.

Management and Control Integrated Solutions: Based on our careful research of the demand and requirements of manufacturing industries for information technology, we also offer management and control integrated solutions. Our solutions are based on the HOLLiAS (Hollysys Integrated Industrial Automation System) platform, which includes features for the fourth generation of DCS and functions for the international mainstream DCS. HOLLiAS is an open system software platform that integrates various management functions and control systems with procured peripheral equipment, self-produced core hardware and the customer's existing hardware and software. Using the HOLLiAS platform, we can provide customized solutions to meet the application requirements of different industries.

We established a project group for each potential customer, which has a team of systems engineers and managers engaged in providing 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;

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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

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- 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 $1400 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 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); General Electric (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 of 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.

The industrial automation market was estimated to grow at an annual rate of 16.1% between 2005 and 2009, by ARC. Given the economic downtown experienced over the past year, the growth rate in China DCS market for these two years should be approximately around -5% to flat. In 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. Up to date we have implemented over 6500 projects with over 1700 customers. Clientele 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, and also Supcon from local. 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 exciting end-market for Hollysys is high-speed rail market in China, where we command leading position in providing high-speed passenger train control and protection systems. High-speed rail is a relatively new development in China. The Ministry of Rail of China developed its own high-speed rail signaling technological specifications, one is called C2 for 200-250km/hour train speed category, the other is called C3 for 300-350km/hour train speed. There are few lines in operation in C2 category in China and there is no operating line for the C3 category. However, there are 3 lines currently under construction in the C3 category: the Zhengzhou-Xian line, Wuhan-Guangzhou line, and Shenzhen-Guangzhou line. Hollysys is contracted to provide automation and control products for the Zhengzhou-Xian line, and the Shenzhen-Guangzhou line.

China is planning to have 13,000 kilometers of high-speed railways in operation in the year of 2012, exceeding the current capacity of total high-speed railway kilometers of 11,345 kilometers in operation in 19 countries in the world. According to China's Ministry of Rail, there are 54 high-speed rail lines planned to be built in China till 2012, among which are expected to be, 16 lines under the C3 category and 38 lines under the C2 category. The lines are generally described as "4 Horizontals and 4 Verticals," referring to their positions on the map of China. The Four Vertical lines include the Beijing-Guangzhou line, Beijing–Shanghai line, Haerbin-Dalian-Shenyang-Beijing line, and Shanghai-Hangzhou-Shenzhen line. The Four Horizontal lines include the Lanzhou-Xian-Zhengzhou-Beijing line, Shanghai-Wuhan-Chongqiong-Chengdu line, Hangzhou-Changsha-Kunming line, and Shijiazhuang-Qingdao line. The high-speed rail build-out plan also includes inter-city high-speed lines at the Zhu Jiang River Delta, Yangtze River Delta, and Beijing-Tianjin-Tangshan areas. As one of the five automation products providers under C2 category, and one of the only two automation products providers to C3 segment, we believe that Hollysys is well positioned to benefit from this unprecedented high-speed railway build-out in the world.

Hollysys also provides its proprietary software platform and solutions of Surveillance Control and Data Acquisition (SCADA) to subway market. China subway market is expected to receive significant government spending due to urbanization and environmental concerns of urban public transit system. According to China's Ministry of Housing and Urban-Rural Development, 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. With Hollysys more than 5 years of experience in this market and well-recognized brand name, Hollysys is putting in place a strategy to capture this fast-growing market.

Nuclear Market

Hollysys is 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 a meager 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 the PRC government's stimulus plan, China's installed nuclear power generating capacity is expected to reach 70 GW by 2020. Approximately, 1 nuclear reactor generates 1GW electricity. Hollysys has formed a 50/50 joint venture with China's leading nuclear station operator, China Guangdong Nuclear Power Holdings Corporation, to provide its proprietary non-safety automation and control products to the nuclear stations constructed by China Guangdong Nuclear Power Holdings Corporation. This strategic alliance positions Hollysys to be the dominant nuclear automation system provider in China. China Guangdong Nuclear Power currently owns and operates 4 of the 11 reactors in operation and 14 of the 20 nuclear reactors currently approved for construction.

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, because product sales are not part of the integrated contracts, 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.

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:

1. 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.

2. 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.

3. 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.

4. 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 will be held responsible for this delay, in accordance with the terms specified in respective integrated contracts.

Competition

We compete with various domestic and international producers offering automation systems to the Chinese 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 before us. We believe that our primary competitors in the market for our products are ABB, Honeywell, Emerson and Siemens.

When compared to our competitors, we believe that we have the following competitive advantages:

- 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 has been the low cost of engineers in China relative to those in the west to increase the sophistication of its products and to accelerate their development. 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 its 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 the 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.

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- 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 include 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.

- Use of Engineering Sales Personnel. The use of trained engineers in product and system design is complemented by the use of engineers in the sales process as well. The advantages of doing so are substantial. They include the ability to understand from the beginning the needs of the customer and how to address them and the ability to convey that information to the team that will ultimately develop the system to be installed.

- Accounting for the Broad Array of Chinese Customers' Capabilities. China's rapid growth and industrialization distinguish it from other manufacturing nations in some ways. There are many "established" Chinese companies that operate in facilities that are decades old, many companies that operate in new or recently upgraded facilities, and the largest number that fall somewhere in between. We understand, to a greater extent than our western competitors, the full range of needs and capabilities that Chinese customers possess, and we have designed our business to meet them. As a result, we are able to offer even the most basic control systems solution while also providing the most sophisticated systems available to applications that meet the rigorous requirement of the highly complex and demanding nuclear power industry.

- Pace of Product Development. Another way that we keep ahead of our competitors is by our pace of development. HOLLiAS is the fourth generation of controller systems developed by us, and it took us only a little more than a decade after our first operational system to achieve this breakthrough. We believe that our competitors are frequently hampered by institutional factors that slow the product development process, and as a result, their products cannot incorporate the latest advances in electronics.

- Maintenance Services. Automation systems require regular maintenance to operate within customer guidelines. Older analog systems were well within the capability of many customers to maintain on their own. However, as automation systems shift to electronic components utilizing custom software and digital signaling, their complexity has increased and have made it less easy for customers to maintain their systems independently. To meet this growing customer need we offer our customers maintenance services along with our products. Our regional sales and services offices place us within easy reach of a very high proportion of our customer and potential customer base, which makes it possible for a single maintenance technician to cover maintenance calls for several different customers each week. An added advantage to offering maintenance services is the benefits derived from the strengthened relationship with our customers. Effective maintenance services, leads to increased customer satisfaction, customer loyalty, and increased business opportunities. Offering ongoing services, which not only create the opportunity to generate additional revenue, but enable us to troubleshoot installations effectively, help to ensure that maximum benefit is derived from the system, and gives us the ability to identify the need for new products and services that will benefit the customer and generate additional business for us.

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Manufacturing and Raw Materials

We assemble our products from subcomponents provided by others or we outsource the production to qualified vendors. We acquire advanced printed circuit board components from high quality suppliers. We rely on our manufacturing management department to coordinate the procurement of raw materials and outsourced processing, including the procurement of components and standard parts (such as cables and connectors), and outsourced processing of Polyvinyl Chloride (PVC) coating, shells, and printed circuit boards. Our products are subjected to rigorous testing in our facilities prior to shipment.

In 1997, Beijing Hollysys passed the ISO9001 international quality assurance system certification. And in 2002, Beijing Hollysys obtained the ISO9001:2000 certificate, which covers all the processes including research and development, sales and distribution, manufacturing, engineering, technical support and repair service, etc.

Seasonality

Our operating results and operating cash flows historically have not been subject to seasonal variations. This pattern may change, however, as a result of new market opportunities or new product introductions. Revenues of our business as a whole do not tend to fluctuate significantly by season, although compared to other quarters, our third quarter is relatively slow due to the Chinese New Year holidays.

Regulation

We operate our business in China under a legal regime that consists, at the national level, of the State Council, which is the highest authority of the executive branch of the PRC central government, and several ministries and agencies under its leadership, including: the Ministry of Agriculture and its local authorities; the Ministry of Commerce and its local authorities; SAFE and its local authorities; the State Administration of Industry and Commence and its local authorities; and the State Administration of Taxation, and the Local Taxation Bureau. The following sets forth a summary of significant regulations or requirements that affect our business activities in China and our shareholders' right to receive dividends and other distributions from us.

- Foreign Currency Regulations. We are subject to the PRC's foreign currency regulations. The PRC government has control over RMB reserves through, among other things, direct regulation of the conversion of RMB into other foreign currencies. Although foreign currencies which are required for "current account" transactions can be bought freely at authorized Chinese banks, the proper procedural requirements prescribed by Chinese law must be met. At the same time, Chinese companies are also required to sell their foreign exchange earnings to authorized Chinese banks and the purchase of foreign currencies for capital account transactions still requires prior approval of the Chinese government.

- Taxation. On March 16, 2007, the National People's Congress, the Chinese legislature, passed the new Enterprise Income Tax Law, or New EIT Law, which became effective on January 1, 2008. The New EIT Law applies a unified enterprise income tax, or EIT, rate at 25% to both FIEs and domestic invested enterprises. According to a grandfathering provision of the Notice on Transitional Preferential Policies of Enterprise Income Tax published by the State Council, enterprises that are subject to an EIT rate below 25% may continue to enjoy such lower rate which will be gradually transitioned to the new EIT rate within five years of the effective date of the New EIT Law, and enterprises that are currently entitled to exemptions from, or reductions in, applicable EIT for a fixed term may continue to enjoy such treatment until the fixed term expires. Under the New EIT Law, companies designated as High- and New-Technology Enterprises may enjoy a reduced national enterprise income tax of 15%. "Administrative Measures for Assessment of High-New Tech Enterprises," or Measures, and "Catalogue of High/New Tech Domains Strongly Supported by the State," or Catalogue (2008), jointly issued by the Ministry of Science and Technology and the Ministry of Finance and State Administration of Taxation set forth general guidelines regarding criteria as well as application procedures for qualification as a High- and New-Tech Enterprise under the New EIT Law. Both Beijing Hollysys and Hangzhou Hollysys have met the qualifications for the High- and New-Technology Enterprise designation and are accordingly subject to a reduced national enterprise income tax of 15%.

- Dividend Distribution. Under PRC law, FIEs in China, including Hangzhou Hollysys, may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting principles. In addition, FIEs in China are required to set aside at least 10% of their after-tax profit based on PRC accounting standards each year for their general reserves until the accumulative amount of such reserves reaches 50% of registered capital. These reserves are not distributable as cash dividends. The board of directors of a FIE has the discretion to allocate a portion of its after-tax profits to staff welfare and bonus funds, and expansion (development) funds which may not be distributed to equity owners except in the event of liquidation. In addition, under the new EIT Law, effective as of January 2008, dividends from Beijing Hollysys to us will be subject to a withholding tax of 5%, whereas those from Hangzhou Hollysys will be subject to a withholding tax of 10%.

The foregoing summary does not purport to be complete and is qualified by reference to the relevant provisions of applicable law in the jurisdictions in which we operate. We believe that we are currently in compliance with all applicable laws and regulations relating to our business.

Marketing, Sales and Customer Support

Our marketing and sales activities are focused on the Chinese domestic market where there is a growing demand for automation and control products, systems and services. Because our market strategy is to tailor products to specific customer needs, our sales teams consist of a complementary group of sales personnel and hardware and software engineers from a variety of disciplines. Employing a pool of skilled personnel at this early stage accelerates the design and the subsequent production of a particular customized solution, typically exceeding that of our competitors. Our sales team possess significant hands-on, industry-specific experience which permit them to do on-site process analyses, which in turn, makes the design and implementation of upgrades simpler. The result is a system that is more effective, efficient and reliable, which in turn leads to a truly satisfied customer.

Our direct sales force is organized into three groups, as follows:

- Department of Region Sales: there are 10 geographic sales regions covering 30 provinces in China. The direct sales professionals provide business consulting, promote pre-sale activity and serve as customer contacts.

- Department of Customer Service is in charge of managing relations with all contracted customers, and improving customer satisfaction by coordinating responses to the client's information request, sale of supplemental parts or components, and customer visits.

- Department of Marketing Plan has been established to facilitate strategic cooperation with certain specialized manufacturers, in order to expand the specific fields, such as Digital Electro-Hydraulic Control Systems, air separation and desulphurization.

Currently, the programmable logic controller products are in an early marketing stage, and we are using several contracted distributors and developing more distributors to expand sales of its programmable logic controller products.

We identify and target market segments and select target sales opportunities on a national level, and we also conduct sales opportunity studies to ensure that adequate regional sales resources are available. Sales quotas are assigned to all sales personnel according to annual sales plans. We classify market segments and target opportunities on national and regional levels. This classification helps us to determine our primary sales targets and to prepare monthly and quarterly sales forecasts. Then, the sales team approves target projects, develops detailed sales promotion strategies and prepares reports on order forecasts, technical evaluation, sales budgeting expense, schedules and competition analysis. After the report has been approved, a sales team is appointed consisting of sales personnel and technicians.

Our market strategy focuses on building strategic cooperative relationships with its customers, educating them about technological developments and reflecting their interests in our products and services. We employ marketing personnel to conduct market research, to analyze user requirements and to organize marketing communications. Our marketing team engages in a variety of marketing activities, including:

- publishing internal research reports and customer newsletters;
- conducting seminars and conferences;
- conducting ongoing public relations programs; and
- creating and placing advertisements.

We actively participate in technology-related conferences and demonstrate our products at trade shows or at exhibitions targeted at our existing and potential customers. We also evaluate a range of joint-marketing strategies and programs with our business partners in order to take advantage of their strategic relationships and resources. We also support our customers by offering field services such as maintenance and training services, which help customers to cut cost and improve operating efficiency. As of June 30, 2009, we employed 205 direct sales personnel who were assigned to three business areas: railway transportation, nuclear power, and DCS. Sales activities are coordinated from our offices in Beijing and Hangzhou. All sales staff are responsible for implementing the sales policies established at headquarters.

C. Property, Plants and Equipment

Our principal executive offices are located 10 Jiancaicheng Middle Road, Xisanqi, Haidian District, Beijing, China. We lease or own the land use rights to property at the following principal locations, each of which contains principal administrative offices, sales and marketing offices, research and development facilities, and manufacturing facilities:

Location	Approximate Sq. Meters	Ownership
Beijing	18,000	Owned
Beijing	4,937	Leased
Hangzhou	25,000	Owned

We lease the 4,937 square meter space in Beijing, subject to a five-year factory lease agreement, dated as of May 22, 2006, between Beijing Hollysys and Beijing Lighting Fixture Co., Ltd., or Beijing Lighting, at a monthly rate of approximately RMB100,000. The lease will expire on July 19, 2011.

The manufacturing facilities at the above locations are used for system integration production, including hardware testing instruments, auxiliary material processing, packaging and shipping, and for self-made product integration production, including inspection and testing.

Due to rapid growth of our business, we have outgrown our current Beijing facilities and we are currently constructing a new 150,000 square meter facility in the Beijing Yizhuang Economic Development Zone which will have one new production line and sufficient space for addition of another production line as needed. We have budgeted $51 million for capital expenditure in connection with the construction of this new facility and at June 30 2009, we had already utilized $25 million of this amount. We expect that the bulk of the remaining capital will be expended in fiscal years 2010 and 2011, which we believe will be well covered by cash generated by our operations.

D. Organizational Structure

The following diagram illustrates our corporate structure as of the date of this annual report. We are a holding company with no operations of our own. We conduct our operations in China through our Chinese operating companies, Beijing Hollysys, Hangzhou Hollysys and Hollysys Haotong.

Our corporate headquarters are located at 10 Jiancaicheng Middle Road, Xisanqi, Haidian District, Beijing, 100096, China. Our telephone number is (+86) 10 58981386. We maintain a website at http://www.Hollysys.com, that contains information about our company, but that information is not a part of this annual report.

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ITEM 4A. UNRESOLVED STAFF COMMENTS

Not Applicable

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Item 3. Key Information—D. Risk Factors" or in other parts of this annual report on Form 20-F.

Overview

Through our Chinese operating subsidiaries, we are one of the leading automation systems providers in China, developing a number of core technologies and completing numerous projects utilizing a wide array of automation products. With our philosophy of sincere concern for customers and our technical innovation capabilities, we specialize in the research, development, production, sale and distribution of industrial automation for digital railway signals and information systems, e-government, motor drive transmissions and safety controls for nuclear power reactors.

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 our revenue mainly from the integrated contracts we have won through the bidding process, which accounts for over 90% of the total consolidated revenue. In addition, we also sell spare parts and component products to customers for maintenance and replacement purposes after the completion of the integrated solution contract. Product sales are not part of the integrated contracts. Therefore, it is another stream of revenue but minor in volume.

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 we offer consists of hardware, software and services, all of which are customized to meet the customer's particular needs and technical specifications. None of hardware, software and service has independent functionality, and therefore cannot be sold separately to customers. The following table sets forth the information regarding the contracts we won during the last three fiscal years and backlog at the dates indicated:

	Years Ended June 30,		
	2007	2008	2009
Number of new contracts won during the year	1,161	1,293	1,194
Total amount of new contracts (mm)	$ 138.77	$ 216.40	$ 201.66
Average price per contract	$ 119,526	$ 167,364	$ 168,892

	As of June 30,		
Backlog Situation:	2007	2008	2009
Contracts newly entered and unfinished (mm)	$ 67.60	$ 124.42	$ 115.52
Contracts started in the prior year and unfinished (mm)	$ 34.32	$ 54.03	$ 73.42
Total amount of backlog (mm)	$ 101.92	$ 178.45	$ 188.94

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As indicated above, both the amount of new contracts won and the amount of backlog have been increasing steadily during the past three years.

As a growing company, we have achieved significant progress in the past three years. Our total consolidated revenues for the fiscal year ended June 30, 2009 was $157.50 million, compared to $121.50 million for the prior fiscal year, representing an increase of 29.6%, followed by a growth of 19.3 % from $101.89 million in fiscal 2007.

Recent Developments

Subsequent to the fiscal year ended June 30, 2009, the Company completed the acquisition of 1.78% minority interest in Beijing HollySys, by cash consideration of RMB 18 million in June and July, 2009. In view of the intended acquisition, the cash consideration prepaid in June was classified as Deposit for acquisition of equity interest from minority interest on the consolidated balance sheet as of June 30, 2009.

Key Factors Affecting Our Growth, Operating Results and Financial Condition

Our future growth, operating results and financial condition will be affected by a number of factors including:

- The ability in developing new products and systems in order to improve competitiveness, which can increase both in sales revenue and 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.

- The success in expanding our business in targeted emerging markets and overseas market, which may require us to overcome domestic competitions and any trade barriers.

- Our ability to retain our existing customers and to explore additional business opportunities. Since we do not have long-term purchase commitments from customers, so our customers can shift to other competitors for future projects. It is important to maintain our customer base in order to sustain and expand our business.

- The success of our business also depends on securing a steady stream of new customers. In order for our business to continue to succeed and grow, it is vital to secure contracts with new customers on a regular basis.

- The ability to secure adequate engineering resources and relatively low cost engineering staff can increase our profitability and potential business prospects. One of the competitive advantages that we enjoy is the access to lower cost engineering staff as compare to those of our Western and Japan-based competitors. The plentiful supply of affordable engineering talent in China is a key element of our overall business strategy.

- Further improvement in product design and maintaining high standard of quality control, which can reduce or avoid product defects. Any product defects will incur additional costs and cause damage to business reputation.

- The ability in securing and protecting our intellectual property rights will be critical, as our business is based on a number of proprietary products and systems, and we strive to strengthen and differentiate our product portfolio by developing new and innovative products and product improvements.

- The success in penetrating into the railway and nuclear power market sectors can bring in revenues and margins. In addition to the traditional industrial automation business, our plan for future growth includes an increasing emphasis on rail control systems and nuclear power generation control systems.

- The ability to obtain greater financial resources to match or even exceed our major competitors, in order to compete effectively with them, and to weather any extended weaknesses in the automation and control market.

- The continued growth in Chinese industry and Chinese economy in general. This continued growth will create more business opportunities for us, as industrial companies in China are our principal source of revenues.

- The ability to maintain key personnel and senior management, who will have significant impact and contribution to our future business. The ability to attract and retain additional qualified management, technical, sales and marketing personnel will be vital.

- The continuation of the preferential tax treatment and subsidies currently available to our PRC subsidiaries will be critical to our future operating results. If governmental subsidies were reduced or eliminated, our after-tax income would be adversely affected.

- The continued appreciation in Renminbi (RMB) against US dollars will result in future translation gain as most of our assets are denominated in RMB. In addition, some of our raw materials, components and major equipment are imported from overseas. In the event that the RMB appreciate against other foreign currencies, our costs will decrease and it will increase our profitability.

Critical Accounting Policies

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company transactions and balances are eliminated during the process of consolidation. Investments in investee companies in which the Company does not have a controlling interest (interest holding by the Company from 20% up to 50%), or in which the Company holds more than 51% interest, however, the minority interest in that entity has participation rights defined in EITF 96-16, are accounted for using the equity method. The Company's shares of earnings (losses) of these investee companies are included in the accompanying consolidated statement of income. These consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America ("U.S. GAAP").

Revenue Recognition

Revenues generated from designing, building, and delivering customized integrated industrial automation systems and providing relevant solutions are recognized over the contractual terms based on the percentage of completion method. The contracts for designing, building, and delivering customized integrated industrial automation systems are legally enforceable binding agreements between the Company and customers. Performance of these contracts will often extend over long periods, and the Company's right to receive payments depends on its performance in accordance with these contractual agreements. The duration of contracts the Company performs is depending on the contract size in terms of dollar amounts. In general, the bigger the contract size is, the longer the duration of that contract is. The duration of a small contract is less than one year without including warranty period. The duration of a large contract is longer than one year without including warranty period. Including the warranty period, all of contracts have their duration longer than one year, ranging from 16 months to 61 months. The operating cycle of the Company is determined by a composite of many individual contracts in various stage of completion and is measured by the duration of the average time intervening between the acquisition of materials or service entering the construction process and the substantial completion of contracts. Based on the historical experience, the operating cycle of the Company exceeds one year.

In accordance with AICPA's SOP 81-1, "Accounting for Construction Contracts and Certain Production-Type Contracts," revenue recognition is based on an estimate of the income earned to date, less income recognized in earlier periods. Estimates of the degree of completion are based on the costs incurred to date comparing to the expected total costs for the contracts. Revisions in the estimated profits are made in the period in which the circumstances requiring the revision become known. Provisions, if any, are made currently for anticipated loss on the uncompleted contracts. Revenue in excess of billings on the contracts is recorded as costs and estimated earnings in excess of billings. Billings in excess of revenues recognized on the contracts are recorded as deferred revenue until the above revenue recognition criteria are met. Billings are rendered based on agreed milestones included in the contracts with customers. There are different milestones among the contracts the Company has won. In general, there are four milestones: 1) system manufacturing, 2) system delivery, 3) installation, trial-run, and customer acceptance, and 4) expiration of a warranty period. The amount to be billed when each of the specified milestones is reached has been specified in a contract. All contracts have the first milestone, but not all contracts have a prepayment.

The Company recognizes 100% of the contractual revenue at the end of customer acceptance stage as the Company estimates that no further major costs will incur under a contract, a signed customer acceptance document has been obtained, and a warranty period starts to count. Revenues are presented net of taxes collected on behalf of government.

Revenue generated from sales of electronic equipment is recognized when persuasive evidence of an arrangement exists, delivery of the products has occurred, customer acceptance has been obtained, which means the significant risks and rewards of the ownership have been transferred to the customer, the price is fixed or determinable and collectability is reasonably assured.

Inventories

Inventories are composed of raw materials and low value consumables, work in progress, and purchased and manufactured finished goods. Inventories are stated at the lower of cost or the market value.

On January 1, 2009, the Company elected to change the "costing method" for purchased inventories previously accounted for on the "weighted average basis" to the "first-in, first-out basis". The percentage of purchased inventories accounted for under the weighted average method shared approximately 64% of the closing inventories at December 31, 2008. The Company believe that purchased inventories measured based on first-in first-out basis can better reflect the current value of purchased inventories on the Consolidated Balance Sheet and enhances the matching of future cost of sales with revenues. Since the change of the inventories costing method did not result in a material cumulative difference or a material difference in any one reporting period, and consequently the prior periods figures have not been restated. The cumulative effect of the accounting change, which was immaterial, was reflected in the results of operations in the year ended June 30, 2009.

The Company makes provisions for estimated excess and obsolete inventory based on its regular reviews of inventory quantities on hand and the latest forecasts of product demand and production requirements from its customers. The Company writes down inventories for not saleable, excess or obsolete raw materials, work-in-process and finished goods by charging such write-downs to cost of sales. In addition to write-downs based on newly introduced parts, statistics and judgments are used for assessing a provision on the remaining inventory based on salability and obsolescence..

Warranty

Warranty is a major term under an integrated contract, which will last, in general, for twelve months or be specified under a contract. The Company estimates a warranty liability under a contract using a percentage of revenue recognized, which is derived from its historical experience, in order to recognize a warranty cost for a contract in the proper period of time. In addition, at the end of each reporting period, the Company estimates whether or not the accrued warranty liabilities are adequate based on 1) the outstanding warranty time period of a contract which has entered into the warranty period, 2) the total revenue has recognized on a contract which has been under the warranty period, and 3) all contracts which have been under the warranty period. The Company adjusts the accrued warranty liabilities in line with the result of its assessment.

Accounts Receivable and Cost and estimated earnings in excess of billings

Performance of the contracts often will extend over long periods and the Company's right to receive payments depends on its performance in accordance with these contractual agreements. The Company bills a customer in accordance with the amount specified under the contract from the cost and estimated earnings in excess of billings when the Company's performance has reached a milestone. In general, among four milestones, each interval of two contiguous billings under a contract is within one year (under certain railway control system contracts, the interval of two contiguous billings is longer than one year) and the last billing to be issued for a contract is at the end of the warranty period. When a customer makes a prepayment at the start of a contract, the amount received will be recorded as deferred revenue. The deferred revenue would be recognized as revenue under the percentage of completion method along with the progress of a contract. If no prepayment is received by the Company, revenue would be recognized through cost and estimated earnings in excess of billings. Accordingly, when a particular milestone is reached, a particular amount of cost and estimated earnings in excess of billings will be transferred into accounts receivable. Cost and estimated earnings in excess of billings are usually billed within one year. The Company does not specify credit terms in its invoices and expect that its customers will make their payments upon receipt even though the contract terms say that a specific amount is due when a milestone is reached. The Company does not require collateral from its customers. Based on the prevailing collection practice in China, it is a reasonable expectation for the enterprises in automation industry to take over one year to collect accounts receivable.

The Company issues invoices to its customers without specifying credit terms and consequential interests charge for late payments by its customers. The Company reviews the status of contracts periodically and decided how much allowance for doubtful accounts should be made based on factors surrounding the credit risk of customers, as well as its historical experience. The Company set up bad debt allowance for an individual customer if there is a deterioration of the customer's creditability and the assessed probability of default is higher than the historical experience.

Impairment of Long-Lived Assets

The Company adopts the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. Whenever any such impairment exists, an impairment loss will be recognized for the amount by which the carrying value exceeds the fair value. Losses on long-lived assets to be disposed of are determined in a similar manner, except that fair market values are reduced for the cost to dispose.

Goodwill and Impairment Test

Goodwill resulting from an acquisition is measured at the excess of the cost of the business combination over the fair value of the assets acquired and liabilities assumed. Goodwill will not be amortized, instead be tested for impairment at least annually as prescribed by SFAS No. 142. When impairment occurs, the carrying value of goodwill is written down and a charge is recorded against net income. .

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes", which requires an entity to recognize deferred tax liabilities and assets. Deferred tax assets and liabilities are recognized for the future tax consequence attributable to the difference between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are measured using the enacted tax rate expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that included the enactment date. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Current income taxes are provided for in accordance with the laws of the relevant tax authorities.

The Company adopted the FASB's Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company's policy on classification of all interest and penalties related to unrecognized tax benefits, if any, as a component of income tax provisions.

Share-based compensation

The Company adopted SFAS No. 123 (revised 2004) ("SFAS No. 123(R)"), ''Share-based Payment'', which requires that share-based payment transactions with employees, such as share options, be measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense over the requisite service period, with a corresponding addition to equity. Under this method, compensation cost related to employee share options or similar equity instruments is measured at the grant date based on the fair value of the award and is recognized over the period during which an employee is required to provide service in exchange for the award, which is generally the vesting period.

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) changes accounting for acquisitions that close beginning in 2009. SFAS No. 141R broadens the guidance of SFAS No. 141, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. SFAS No. 141R expands on required disclosures to improve the statement users' abilities to evaluate the nature and financial effects of business combinations. SFAS No. 141R is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the potential impact on the adoption of SFAS No. 141(R) that may have on its financial position, result of operations and cash flow.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, An Amendment of ARB No. 51" ("SFAS No. 160"). SFAS No. 160 requires that a noncontrolling interest in a subsidiary be reported as equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent's ownership interest and requires fair value measurement of any non-controlling equity investment retained in a deconsolidation. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company does not anticipate that the adoption of SFAS No. 160 will have significant impact on the Company's financial disclosures.

In March 2008, FASB released SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged and is required to be adopted by the Company in the first quarter of fiscal year 2010. The Company does not anticipate that the adoption of SFAS No. 161 will have significant impact on the Company's financial disclosures.

In April 2009, the FASB issued FSP 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP 157-4"). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 157-4 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 157-4 requires comparative disclosures only for periods ending after initial adoption. The adoption of FSP 157-4 in the fourth quarter of fiscal 2009 did not have a material impact on the Company's financial position or results of operations.

In May 2009, the FASB issued SFAS No. 165 "Subsequent Events" ("SFAS No. 165"), which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. The adoption of SFAS No. 165 in the fourth quarter of fiscal 2009 did not have a material impact on the Company's financial position or results of operations.

In June 2009, the FASB issued SFAS No. 166 "Accounting for Transfers of Financial Assets" ("SFAS No. 166"). This statement is intended to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. This Statement must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. The Company is currently evaluating the potential impact on the adoption of SFAS No. 166 may have on the Company's financial position, result of operations and cash flow.

In June 2009, the FASB issued SFAS No. 167 "Amendments to FASB Interpretation No. 46(R)" ("SFAS No. 167"). SFAS 167 seeks to improve financial reporting by enterprises involved with variable interest entities. SFAS No. 167 is applicable for annual periods after November 15, 2009 and interim periods therein and thereafter. The Company is currently evaluating the potential impact on the adoption of SFAS No. 167 may have on the Company's financial position, result of operations and cash flow.

In June 2009, the FASB issued SFAS No. 168 "The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 168"). The FASB approved the FASB Accounting Standards Codification (the "Codification") as the single source of authoritative non-governmental U.S. GAAP to be launched on July 1, 2009. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for interim and annual periods ending after September 15, 2009. The Company does not anticipate that the adoption of SFAS No. 168 will have significant impact on the Company's financial position, result of operations and cash flow.

Financial Position

The following are some financial highlights for the fiscal year ended June 30, 2009:

- Total assets increased by $92.71 million, from $252.73 million as of June 30, 2008 to $345.44 million as of June 30, 2009. The increase was mainly due to a significant increase of $64.63 million in cash and cash equivalents, an increase of $8.44 million in cost and estimated earnings in excess of billings, an increase of $2.64 million in amount due from related parties, an increase of $19.32 million in property, plant and equipment, and an increase of $3.81 million in long-term investment.

- Accounts receivable at June 30, 2009 was $56.55 million, a decrease of $3.85 million, or 6.4%, compared to $60.40 million at June 30, 2008. The decrease was mainly due to our increased efforts made in accounts collection.

- Cost and estimated earnings in excess of billings as of June 30, 2009 were $51.09 million compared to $42.65 million as of June 30, 2008, representing an increase of $8.44 million, or 19.8%. The increase was mainly attributable to the increase in total revenues.

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- Inventory as of June 30, 2009 was $18.84 million, a decrease of $5.83 million, or 23.6%, compared to $24.67 million at June 30, 2008.

- Property, plant and equipment increased by $19.32 million, or 69.5%, from $27.78 million at June 30, 2008, to $47.10 million at June 30, 2009, mainly due to significant input in construction of the new facility, which in expected to be completed in fiscal year 2010.

- Long-term investment at June 30, 2009 was $13.57 million, an increase of $3.81 million, or 39.0%, compared to $9.76 million at June 30, 2008. The increase in long-term investment was mainly due to an additional cash injection of $3.66 million (equivalent to RMB 25 million) made to Beijing Techennergy Co., Ltd..

- Total liabilities at June 30, 2009 were $149.42 million, increased by $61.63 million, or 70.2%, compared to $87.79 million at June 30, 2008. The increase in liabilities was mainly due to an increase of $35.91 million in short-term and long-term bank loans, an increase of $14.24 million in accounts payable, and an increase of $10.93 million in construction costs payable.

- Bank loans at June 30, 2009 increased by $35.91 million, or 307.87%, from $11.66 million in fiscal year 2008 to $47.57 million in fiscal year 2009. Of the total increase, $36.59 million (equivalent to RMB 250 million) was a government-subsidized special-purpose loan in connection with the new facility in construction.

- Construction costs payable related to the new facility was $10.93 million and nil as of June 30, 2009 and 2008, respectively, as the construction progress improved significantly in fiscal 2009.

- Accounts payable at June 30, 2009 was $37.42 million, representing an increase $14.24 million, or 61.4%, compared to $23.18 million at June 30, 2008.

Operating Results

Comparison of Fiscal Years Ended June 30, 2009 and 2008

Operating Revenues: For the year ended June 30, 2009, total revenues amounted to $157.50 million, an increase of $36.00 million, compared to $121.50 million for the prior fiscal year, representing a significant increase of 29.6%.

Integrated contract revenue accounted for $149.30 million of total revenues, an increase of $36.95 million, or 32.9%, compared to $112.36 million for the prior fiscal year. The increase in revenues was mainly attributable to a significant increase of $30.47 million in railway automation and control and system integration projects for subway systems. Such contracts were for larger contract amounts and at a higher gross profit rate.

Approximately $8.20 million of total revenues related to product revenue, a decrease of $0.94 million, or 10.3%, compared to $9.14 million in product revenue for the prior year. Product revenue depends on overall demand for the Company’s spare parts for customers’ maintenance and replacement purposes during the 2009 fiscal year.

Revenue Backlog: An important measure of the stability and growth of the Company’s business is the size of its backlog, which represents the total amount of unrecognized revenue associated with existing contracts. Any deferral of revenue recognition is reflected in an increase in backlog as of the end of current period. Our backlog as of June 30, 2009, amounted to $188.94 million, representing an increase of $10.49 million, or 5.9%, compared to $178.45 million as of June 30, 2008.

Of the total backlog as of June 30, 2009, the unrecognized revenue associated with new contracts signed in the 2009 period was $115.52 million and the carry forward amount of the outstanding contracts from the prior year was $73.42

million. The total backlog as of June 30, 2008 comprised of $124.42 million from new contracts signed in fiscal year 2008, and $54.03 million from contracts carried forward from prior year.

Cost of Revenues: Cost of revenues can be divided into cost of integrated contracts and cost of products sold, in line with the categories of revenues. For the year ended June 30, 2009, the total cost of revenues amounted to $102.92 million, an increase of $18.05 million, or 21.3%, compared to $84.87 million for the prior fiscal year. The increase was due to an $18.01 million increase in the cost of integrated contracts, and a $0.04 million year over year increase in the cost of products sold.

The cost of integrated contract revenue consists primarily of three components: cost of equipment and materials, labor costs and other manufacturing expenses incurred from designing, building and delivering customized automation solutions to customers. The total cost of integrated contracts was $99.42 million for the fiscal year ended June 30, 2009, compared to $81.41 million for the prior fiscal year, representing an increase of $18.01 million, or 22.1%. The increase was primarily due to an increase of $18.08 million in the cost of equipment and materials related to the higher cost of equipment imported for the railway automation and control projects and system integration projects for subway systems during the 2009 period. Labor cost accounted for 4.8% of the cost of integrated contract revenue for the 2009 period, compared to 7.5% for the prior fiscal year; cost of equipment and materials accounted for 78.7%, compared to 73.9% for the prior fiscal year; and other manufacturing expenses accounted for 16.4%, compared to 18.5% for the prior fiscal year. Labor cost accounted for 3.2% of the integrated contract revenue for the 2009 period, compared to 5.5% for the prior fiscal year, which the change was caused by the components of cost of integrated contracts which varied in accordance with customer specifications in the 2009 period. Cost of equipment and materials accounted for 52.4%, compared to 53.6% for the prior fiscal year. Other manufacturing expenses accounted for 10.9%, which decreased from 13.4% for the prior fiscal year, mainly due to the Company's efficiency improved during the 2009 fiscal year. The cost components of integrated contracts were determined and varied according to requirements of different customers.

Sales of products represent sales of spare parts (either self-made or purchased from outside vendors) to customers for maintenance and replacement purposes. The products purchased from outside vendors have different functions and capabilities from our self-made products. We decide whether or not to purchase from outside vendors or make the necessary products ourselves, based on the needs and preferences of different customers and efficiency considerations. Therefore, as a percentage of the cost of products sold, the self-made products and outsourced products have varied significantly from time to time. As our self-made products generally contribute higher margins than products purchased from outside vendors, sales of a greater portion of self-made products generally result in lower costs of products sold. The cost of products sold for fiscal year ended June 30, 2009 was $3.50 million, an increase of $0.04 million, compared to $3.46 million for the prior fiscal year.

Gross Margin: For the year ended June 30, 2009, as a percentage of total revenues, the overall gross margin was 34.7%, compared 30.1% for the prior fiscal year, primarily because of the increase in gross margin for integrated contracts. The gross margin for integrated contracts was 33.4% for the year ended June 30, 2009, compared to 27.5% for the prior year. The increase in gross margin for integrated contracts was due mainly to our different sales mix during the 2009 period, as a higher proportion of railway automation and control projects generated a higher margin. The gross margin for products sold was 57.3% for the fiscal year ended June 30, 2009, compared to 62.2% for the prior fiscal year.

Selling Expenses: Selling expenses mainly consist of compensation, traveling and administrative expenses related to marketing and sales and promotion activities of the Company's marketing and credit departments. Selling expenses were approximately $10.02 million for the fiscal year ended June 30, 2009, an increase of 3.5%, or $0.34 million, compared to $9.68 million for the prior fiscal year, mainly due to increase in payroll expense for sales personnel during the 2009 period. As a percentage of total revenues, selling expenses accounted for 6.4% and 8.0% for the fiscal year ended June 30, 2009 and 2008, respectively. The Company has established guidelines to monitor and evaluate sales performance for its products to customers in different industries and regions to control selling expenses.

General and administrative expenses: General and administrative expenses mainly include compensation, traveling and other administrative expenses of non-sales-related departments, such as the planning and finance department, information systems department and human resources department. General and administrative expenses amounted to $48.98 million for the fiscal year ended June 30, 2009, representing an increase of $22.39 million, or 84.2%, compared to $26.59 million for the prior fiscal year. The increase in general and administrative expenses was mainly due to the increase of $22.24 million in the stock compensation expense on the modification of earn-out shares and granted options. Excluding stock compensation expenses and option expenses, general and administrative expenses should be $9.42 million and $9.50 million, or 6.0% and 7.8% as a percentage to total revenues, for the fiscal years ended June 30, 2009 and 2008, respectively.

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Pursuant to the stock purchase agreement under the re-domestication merger, the Company agreed to issue 2 million shares to the original stockholders of Gifted Time if the Company could achieve or exceed an after-tax profit of $32 million for the 12 months ended December 31, 2008. After-tax profit was computed using US GAAP and referred to comprehensive income, excluding (i) any after-tax profits from any acquisition by the Company or its subsidiaries that involved the issuance of securities that had a dilutive effect on the holders of common stock of the Company, and (ii) any expenses related to the issue of the aforesaid shares. Management determined that the Company achieved such earn-out target for the abovementioned period and the board approved the issuance of the earn-out shares. The Company has accounted for the fair value of the aforesaid shares to be issued for the year ended June 30, 2009 as stock compensation expenses and $17.0 million was recorded in the statement of income. On June 15, 2009, the Company and the original stockholders of Gifted Time agreed to amend the stock purchase agreement to cancel the remaining 7 million incentive shares issuable to the original Gifted Time stockholders under the stock purchase agreement for the calendar years ended December 31, 2009, 2010, and 2011, in exchange for the immediate issuance of 4 million shares to the original Gifted Time stockholders. The Company has accounted for the fair value of the aforesaid 4 million shares as stock compensation expenses and $22.24 million was recorded in the statement of income.

Research and Development Expenses: Research and development expenses comprise mostly employee compensation, materials consumed and experiment expenses for specific new product research and development, and any expenses incurred for basic research on advanced technologies. For the fiscal year ended June 30, 2009, research and development expenses were $8.83 million, compared to $3.83 million for the prior fiscal year. The $5.0 million, or 130.3%, increase was mainly due to increased R&D activities during the 2009 period. As a percentage of total revenues, research and development expenses was 5.6% and 3.2% for the fiscal years ended June 30, 2009 and 2008, respectively.

VAT Refunds: The local governments in Beijing and Hangzhou provide financial subsidies out of the value added tax they collect in order to encourage the research and development efforts of certain enterprises. Beijing HollySys and Hangzhou HollySys both received such refunds. All VAT refunds were accounted for based on hard evidence that the operations of those companies were entitled to receive these refunds or that cash had been received. For the fiscal year ended June 30, 2009, VAT refunds were $5.94 million, compared to $6.16 million for the prior fiscal year, decreased by $0.22 million, or 3.5%. As a percentage of total revenues, VAT refunds were 3.8% and 5.1% for the fiscal years ended June 30, 2009 and 2008, respectively.

Income (loss) from Operations: Income from operations decreased by $10.00 million, or 372.2%, from $2.69 million for the fiscal year ended June 30, 2008, to a loss of $7.31 million for the fiscal year ended June 30, 2009. The decrease in income from operations was primarily due to the increase in stock compensation expenses related to the 4 million share issuance as a result of cancellation of future years' incentive share program and option grants. Excluding stock compensation expenses, operating income as a percentage of total revenues for the fiscal year ended June 30, 2009 was $32.25 million, or 20.5%, as compared to $19.77 million, or 16.3% as a percentage of total revenues for the prior year, an increase that was mainly due to the increase in gross margin level.

Interest Expenses, Net: For the year ended June 30, 2009, net interest expenses decreased by $3.35 million, or 77.8%, from $4.30 million for the prior year, to $0.95 million for the current period. The decrease was primarily due to the recognition of $3.24 million in the amortization of discounts and interests on notes payable related to a bridge loan for prior fiscal year, as compared to nil for the current year. Excluding the interests and amortization of discounts on notes payable related to a bridge loan, net interest expense as a percentage of total revenue would be 0.6% and 0.9% for the fiscal year ended June 30, 2009 and 2008, respectively.

Government Subsidy: The local governments in Beijing and Hangzhou provide financial subsidies to encourage development of certain enterprises. Beijing HollySys and Hangzhou HollySys both received such subsidies. All subsidies were accounted for based on hard evidence that the operations of those companies were entitled to receive these subsidies or that cash had been received. Gross subsidy income received from the government amounted to $1.76 million and $3.16 million for the fiscal year ended June 30, 2009 and 2008, respectively, a decrease of $1.40 million, or 44.3%.

Income Tax Expenses: For the year ended June 30, 2009, the Company's income tax expense was $3.06 million for financial reporting purposes, an increase of $1.97 million, as compared to an income tax expense of $1.09 million for the prior year. Such increase of income tax expenses was mainly due to a deferred tax adjustments recorded in the prior year.

Minority Interest: The minority interest of the Company includes other parties' interests in Beijing HollySys, Hangzhou HollySys and Haotong. The weighted average minority interests in these operating entities were 25.89%, 10.36% and 31.45%, respectively, for fiscal year ended June 30, 2009, as compared to 25.89%, 10.36% and 48.12%, respectively, for the prior fiscal year. The decrease in minority interest in Haotong is mainly due to the acquisition of the remaining 30% share capital of Haotong by the Company during the year. The minority interest for the fiscal year ended June 30, 2009 was $5.19 million, an increase of $2.35 million, or 83.1%, from $2.83 million for the prior year. Such increase was primarily due to more profit contributed by Beijing HollySys and Hangzhou Hollysys for the current year.

Net income (loss) and Earnings (loss) per share: For the fiscal year ended June 30, 2009, the Company's net loss amounted to $(13.85) million or $(0.31) per diluted share, a decrease of $12.17 million, or $0.27 per diluted share, as compared to a net loss of $(1.68) million, or $(0.04) per diluted share, for the prior year. Such decrease was primarily due to the increase of $22.47 million in stock compensation expenses related to incentive shares and granted options, offset by the decrease of $3.24 million in amortization of discounts and interests on notes payable related to the bridge loan during the 2008 period.

Comparison of Fiscal Years Ended June 30, 2008 and 2007

Operating Revenues: For the year ended June 30, 2008, total revenues amounted to $121.50 million, an increase of $19.61 million, compared to $101.89 million for the prior fiscal year, representing a significant increase of 19.3%. Of the total revenues of $121.50 million, the integrated contract revenue accounted for $112.36 million, an increase by $14.98 million, compared to $97.38 million for the prior fiscal year, representing a 15.4% increase. The increase of revenue was due to a greater number of integrated contracts being performed during the 2008 fiscal year. There were 2,378 contracts being performed for the year ended June 30, 2008 compared to 2,089 contracts for the prior fiscal year, a 13.8% increase. Such increase was mainly contributed by a significant increase of $12.30 million in system integration projects for subway systems. Of the $121.50 million of total revenues, approximately $9.14 million related to product revenue, an increase of approximately $4.63 million, compared to $4.51 million of product revenue for the prior year, a 102.9% increase. Such increase reflects an increasing demand for the Company's equipment and parts for customers' maintenance and replacement purposes during this fiscal year.

Revenue Backlog: An important measure of the stability and growth of the Company's business is the size of its backlog, which represents the total amount of unrecognized revenue associated with existing contracts. Any deferral of revenue recognition is reflected in an increase in backlog as of the end of current period. The backlog as of June 30, 2008 amounted to $178.45 million, representing an increase of 75.09%, compared to $101.92 million as of June 30, 2007. Of the total backlog as of June 30, 2008, the unrecognized revenue associated with new contracts signed in the current period was $124.42 million and the carry forward amount of the outstanding contracts from the prior year was $54.03 million, while the total backlog as of June 30, 2007 comprised of $67.60 million from new contracts signed in fiscal year 2007, and $34.32 million from contracts carried forward from prior year, respectively.

Cost of Revenues: For the year ended June 30, 2008, the total cost of revenues amounted to $84.87 million, an increase by $18.77 million, compared to $66.10 million for the prior fiscal year, representing a 28.39% increase. The increase was due to the facts that cost of integrated contracts increased by $17.13 million, and cost of products sold increased by $1.64 million year over year. Cost of revenues can be divided into cost of integrated contracts and cost of products sold, in line with the categories of revenues. The cost of integrated contract revenue consists primarily of three components: cost of equipment and materials, labor costs and other manufacturing expenses incurred from designing, building and delivering customized automation solutions to customers. The total cost of integrated contracts was $81.41 million for the fiscal year ended June 30, 2008, compared to $64.28 million for the prior fiscal year, representing an increase of $17.13 million, or a 26.6% increase. The increase was primarily due to the following factors: 1) an increase of $16.48 million in cost of equipment and materials, as higher cost of equipment imported for the system integration projects for subway systems; and 2) an increase of $1.14 million in labor cost, primarily due to the increase in average labor salary and welfare costs.

As a percentage to cost of integrated contract revenue, labor cost accounted for 7.5%, compared to 7.8% for the prior fiscal year; cost of equipment and materials accounted for 73.9%, compared to 68.0% for the prior fiscal year; and other manufacturing expenses accounted for 18.5%, compared to 24.2% for the prior fiscal year. As a percentage to integrated contract revenue, labor cost accounted for 5.5%, compared to 5.1% for the prior fiscal year, which the change was caused by the increase in average labor salary and welfare costs. Cost of equipment and materials accounted for 53.6%, compared to 44.9% for the prior fiscal year, the increase was driven by increase in imported equipment for system integration projects for subway systems. Other manufacturing expenses accounted for 13.4%, which decreased from 16.0% for the prior fiscal year, mainly due to the components of cost of integrated contracts varied in the current period. The cost components of integrated contracts were determined and varied according to requirements of different customers.

Sales of products represent sales of spare parts (either self-made or purchased from outside vendors) to customers for maintenance and replacement purposes. The outside purchased products and self-made products have different functions and capabilities. The Company decides whether or not to purchase from outside vendors or make the necessary products itself based on the needs and preferences of different customers and efficiency considerations. Therefore, as a percentage of the cost of products sold, the self-made products and outsourced products have varied significantly from time to time. As self-made products generally contribute higher margin than outside purchased products, sales of a greater portion of self-made products generally result in lower cost of products sold. Cost of products sold for the fiscal year ended June 30, 2008 was $3.46 million, an increase of $1.64 million, compared to $1.82 million for the prior fiscal year. The increase in cost of products sold was consistent with the increase in product sales revenue.

Gross Margin: For the year ended June 30, 2008, as a percentage of total revenues, the overall gross margin was 30.1%, compared 35.1% for the prior fiscal year, primarily because of the drop in gross margin for integrated contracts. The gross margin for integrated contracts was 27.5% for the year ended June 30, 2008 compared to 34.0% for the prior year. The decrease in gross margin for integrated contracts was due mainly to different sales mix, as a higher proportion of system integration projects on subway systems which generated a lower margin of around 11%, which is much lower than the average margin level of above 30% for industrial automation projects. The gross margin for products sold was 62.2% for the fiscal year ended June 30, 2008 compared to 59.6% for the prior fiscal year.

Selling Expenses: Selling expenses mainly consist of compensation, traveling and administrative expenses related to marketing and sales and promotion activities of the Company’s marketing and credit departments. Selling expenses were approximately $9.68 million for the fiscal year ended June 30, 2008, an increase of 27.8%, or approximately $2.10 million, compared to approximately $7.58 million for the prior fiscal year. Of the total increase, $1.10 was related to payroll expense of sales personnel, $0.21 million was for travel expense, $0.36 million was for sales promotion and advertisement, and $0.44 million was for other selling expenses and overheads. As a percentage of total revenues, selling expenses accounted for 8.0% and 7.4% for the fiscal year ended June 30, 2008 and 2007, respectively. The Company has established guidelines to monitor and evaluate sales performance for its products to customers in different industries and regions to control selling expenses.

General and administrative expenses: General and administrative expenses mainly include compensation, traveling and other administrative expenses of non-sales-related departments, such as the planning and finance department, information systems department and human resources department. The legal and accounting expenses associated with the efforts of the Company to enter into a business combination with HollySys are also a component of general and administrative expenses.

General and administrative expenses amounted to $26.54 million for the fiscal year ended June 30, 2008, an increase of $19.40 million, compared to $7.14 million for the prior fiscal year, representing an increase of 273.8%. The increase in general and administrative expenses was mainly due to the stock compensation expense on earn-out shares of $17.0 million incurred for fiscal year 2008 while nil for the prior year, and an increase of $2.32million in allowance for doubtful debts. As a percentage to total revenues, general and administrative expenses were 21.8% and 7.0% for the fiscal years ended June 30, 2008 and 2007, respectively. Excluding the stock compensation expenses, general and administrative expenses as a percentage to total revenues would be 7.9% for the fiscal year ended June 30, 2008.

Pursuant to the stock purchase agreement under the re-domestication merger, the Company will issue 2 million shares to the original stockholders of Gifted Time if the Company can achieve or exceed an after-tax profit of $23 million for the 12 months ended December 31, 2007. After-tax profit shall be computed using US GAAP and refers to the comprehensive income; provided that the computation shall exclude (i) any after-tax profits from any acquisition by the Company or its subsidiaries that involved the issuance of securities that has a dilutive effect on the holders of common stock of the Company, and (ii) any expenses related to the issue of the aforesaid shares. Management determined that the Company has achieved such earn-out target for the abovementioned period and the issuance of the earn-out shares is subject to Board approval. The Company has accounted for the fair value of the aforesaid shares to be issued for the year ended June 30, 2008 as stock compensation expenses and $17.0 million was recorded in the statement of income.

Research and Development Expenses: Research and development expenses comprise mostly employee compensation, materials consumed and experiment expenses for specific new product research and development, and any expenses incurred for basic research on advanced technologies. For the fiscal year ended June 30, 2008, research and development expenses were $3.83 million, compared to $3.86 million for the prior fiscal year. As a percentage to total revenues, gross research and development expenses was 3.2% and 3.8% for the fiscal years ended June 30, 2008 and 2007, respectively.

VAT Refunds: The local governments in Beijing and Hangzhou provide financial subsidies out of the value added tax they collect in order to encourage the research and development efforts of certain enterprises. Beijing HollySys and Hangzhou HollySys both received such refunds. All VAT refunds were accounted for based on hard evidence that the operations of those companies were entitled to receive these refunds or that cash had been received. For the fiscal year ended June 30, 2008, VAT refunds were $6.16 million, compared to $4.31 million for the prior fiscal year, increased by $1.85 million, or 42.8%. As a percentage to total revenues, VAT refunds were 5.1% and 4.2% for the fiscal years ended June 30, 2008 and 2007, respectively.

Income (loss) from Operations: Income from operations decreased by $18.84 million, or 87.5%, from $21.53 million for the fiscal year ended June 30, 2007 to $2.69 million for the fiscal year ended June 30, 2008, was primarily due to the stock compensation expenses recognized. Excluding the $17.0 million stock compensation expenses, as a percentage to total revenues, the operating income for the fiscal year ended June 30, 2008 was 16.2% compared to 21.1% for the prior year. The decrease as a percentage of total revenues was mainly due to the decline in gross margin level.

Interest Expenses, Net: For the year ended June 30, 2008, net interest expenses decreased by $3.31 million, or 43.4%, from $7.61 million for the prior year to $4.30 million for the current period. The decrease was primarily due to the decrease of $3.16 million in the amortization of discounts and interests on notes payable. As a percentage of total revenues, the net interest expense for the fiscal year ended June 30, 2008 was 3.5%, compared to 7.5% for the prior fiscal year. Excluding the interests and amortization of discounts on notes payable, as a percentage to total revenue, the net interest expense would be 0.9% and 1.2% for the fiscal year ended June 30, 2008 and 2007, respectively.

Government Subsidy: The local governments in Beijing and Hangzhou provide financial subsidies to encourage development of certain enterprises. Beijing HollySys and Hangzhou HollySys both received such subsidies. All subsidies were accounted for based on hard evidence that the operations of those companies were entitled to receive these subsidies or that cash had been received. Gross subsidy income received from the government amounted to $3.16 million and $4.19 million for the fiscal year ended June 30, 2008 and 2007, respectively, decreased by $1.03 million, or 24.5%.

Income Tax Expenses: For the year ended June 30, 2008, the Company's income tax expense was $1.09 million for financial reporting purposes, a decrease by $1.41 million whereas the income tax expense was $2.50 million for the prior year. Such decrease of income tax expenses was due mainly to a special PRC tax benefit on research and development expenditures of and deferred tax adjustments recorded during this period.

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Minority Interest: The minority interest of the Company includes other parties' interests in Beijing HollySys, Hangzhou HollySys and Haotong. The ownership interests of minorities in these two operating entities were 25.89%, 10.36% and 48.12%, respectively. The minority interest for the fiscal year ended June 30, 2008 was $2.83 million, slightly decrease by $0.23 million from $3.06 million for the prior year.

Net income (loss) and Earnings (loss) per share: For the fiscal year ended June 30, 2008, the Company's net loss amounted to $(1.68) million or $(0.04) per diluted share, a decrease by $14.76 million or $0.61 per diluted share as compared to a net income of $13.08 million or $0.57 per diluted share for the prior year. Such decrease was primarily due to the $17.0 million in stock compensation expenses, offset by the decrease of $3.24 million in amortization of discounts and interests on notes payable.

Liquidity and Capital Resources

Cash Flow and Working Capital

As of June 30, 2009 and 2008 we had approximately $128.89 million and $64.25 million, respectively, in cash and cash equivalents. We believe our working capital is sufficient to meet our present requirements. To date, we have financed our operations primarily through cash flows from financing and operating activities. As of June 30, 2009, we had total assets of $345.44 million, of which cash amounted to $128.89 million, accounts receivable amounted to $56.55 million and inventories amounted to $18.84 million. While working capital was approximately $182.85 million, equity amounted to $173.54 million and our current ratio was approximately 2.81.

The following table shows our cash flows with respect to operating activities, investing activities and financing activities for the 12-month periods ended June 30, 2007, 2008 and 2009:

Cash Flow Item	Fiscal Years Ended June 30,		
	2007	2008	2009
Net cash (used in) provided by operating activities	3,772,439	(3,931,073)	40,127,458
Net cash (used in) provided by investing activities	(34,853,478)	(11,865,752)	(11,940,293)
Net cash (used in) provided by financing activities	29,539,350	59,208,327	35,882,189
Effect of exchange rate changes on cash and cash equivalents	2,231,202	9,170,295	562,754
Net increase (decrease) in cash and cash equivalents	689,513	52,581,797	64,632,108
Cash and cash equivalents, beginning of year	10,979,248	11,668,761	64,250,558
Cash and cash equivalents, end of year	11,668,761	64,250,558	128,882,666

Operating Activities

For the year ended June 30, 2009 net cash provided by operating activities was $40.13 million, compared to net cash used in operating activities of $3.93 million for prior fiscal year 2008. The net cash inflow from operating activities in fiscal year 2009 was primarily due to a decrease in inventories of $5.31 million, an increase in accounts payable of $13.06 million, an increase in tax payable of $3.02 million, and the reconciling item in net income of $39.56 million in stock compensation expenses; which were partially offset by an increase in cost and estimated earnings in excess of billings of $8.3 million, an increase in amount due from related parties of $4.58 million. The decrease in inventories was mainly due to increase in revenues and costs, the increase in accounts payable was primarily due to better credit terms provided by suppliers. The increase in accounts receivable was consistent with increase in revenues.

For the year ended June 30, 2008 net cash used in operating activities was $3.93 million, compared to net cash provided by operating activities of $3.77 million for prior fiscal year 2007. The net cash outflow from operating activities in fiscal year 2008 was primarily due to an increase in accounts receivables of $18.56 million, an increase in inventories of $11.0 million, which were partially offset by an increase in advance from customers of $9.05 million, and the reconciling item in net income of $17.0 million in stock compensation expenses. The increase in accounts receivables was primarily due to the increase in revenues, the increase in inventories was primarily due to higher products demand expected in future and the increase in procurement for imported equipment for subway projects. The increase in advance from customers was consistent with a higher revenue backlog at the fiscal year end.

For the year ended June 30, 2007 net cash provided by operating activities was $3.77 million, compared to net cash provided by operating activities of $7.29 million for prior fiscal year 2006. The net cash inflow from operating activities in fiscal year 2007 was primarily due to the net income for the year of $13.08 million together with the reconciled non-cash items of amortization of discount to notes payable of $4.82 million and minority interest of $3.06 million, an increase in accounts payable of $5.77 million, an increase in advance from customers of $2.02 million and increase in accruals and other payable of $2.21 million; which were partially offset by an increase in accounts receivable of $20.71 million, and an increase in inventories of $5.87 million. The increase in accounts receivables was primarily due to the increase in revenues, the increase in inventories was primarily due to higher products demand expected in future. The increase in accounts payable was primarily due to the better credit terms that we were able to get from our suppliers and an increase in our business volume. The increase in advance from customers was consistent with a higher revenue backlog at the fiscal year end.

Investing Activities

For the year ended June 30, 2009 and 2008, net cash used in investing activities was $11.94 million and $11.87 million, respectively. The net cash used in investing activities for the fiscal year 2009 consisted mainly of a cash outflow of $8.73 million in the purchase of fixed assets, a cash outflow of $3.90 million in the acquisition of long term investments, a cash outflow of $2.20 million prepaid for minority interest, and cash proceeds of $2.10 million from disposal of an equity investee.

For the year ended June 30, 2008 and 2007, net cash used in investing activities was $11.87 million and $34.85 million, respectively. The net cash used in investing activities for the fiscal year 2008 consisted mainly of a cash outflow of $10.03 million in purchase of fixed assets and an increase in amounts due from related parties of $2.34 million in connection with an advance payment for the sourcing of construction materials for our new headquarters.

For the year ended June 30, 2007, net cash used in investing activities was $34.85 million. The net cash used in investing activities for the fiscal year 2007 consisted mainly of an increase in a note receivable from the then sole stockholder of $30 million and a $3.06 million addition in long-term investments.

Financing Activities

For the year ended June 30, 2009 and 2008, net cash provided by financing activities was $35.88 million and $59.21 million, respectively. The net cash inflow from financing activities in fiscal year 2009 primarily comprise proceeds from long-term bank loans of $36.61 million related to the ongoing construction of our new facility, with interest subsidized by the government.

For the year ended June 30, 2008 and 2007, net cash provided by financing activities was $59.21 million and $29.54 million, respectively. The cash generated by financing activities in fiscal year 2008 consisted mainly of:

- A cash inflow of $57.21 million raised from warrants exercised during the period from October 17 to December 17, 2007, in connection with the Company’s call of warrants issued by Chardan during the Chardan IPO process and the subsequent exercise of warrants to purchase 11,442,614 shares at $5.0 per share and the redemption of warrants to 57,386 shares at $0.01 per share, and the Company's collection of cash proceeds of $57.21 million and paid $573.86 to the holders of 57,386 shares of warrants for redemption purposes;

- A net cash inflow of $32.06 million related to proceeds from reorganization and recapitalization, as we completed our re-domestication merger with Hollysys on September 20, 2007, and Hollysys acquired the net assets of Chardan as of the acquisition date, which amounted to $32.06 million in cash.

- A net cash inflow of $11.48 million raised from issuing bonds in connection with a RMB80 million three-year, 6.68% (payable semiannually) corporate bond issuance by Beijing HollySys on December 25, 2007, with maturity on December 28, 2010. In connection with the bond issuance, Beijing Zhongguancun Science and Technology Guaranty Co., Ltd. undertook joint and several guarantee liabilities in full in favor of Beijing HollySys. Concurrently, the China Development Bank has authorized its business department to undertake joint and several guarantee liability in respect of the guarantee liabilities of Beijing Zhongguancun Science and Technology Guaranty Co., Ltd. Beijing HollySys also pledged its property located in Beijing with a net book value of $5.4 million, as at June 30, 2008, to Beijing Zhongguancun Science and Technology Guaranty Co., Ltd. as a collateral;

- A cash outflow of $29.987 million used to pay off the principal and related interest of the bridge loan, which was incurred prior to fiscal year 2007;

- A net cash outflow of $12.92 million in repayments to short-term bank loans; and

- A cash proceed of $4.76 million and repayments of $3.40 million from / to long-term bank loans.

For the year ended June 30, 2007, net cash provided by financing activities was $29.54 million. The net cash inflow from financing activities in fiscal year 2007 primarily consisted of proceeds from notes payable of $29.987 million related to a bridge loan, proceeds from short term bank loans of $6.49 million, and was partially offset by repayments to long term bank loans of $5.10 million and dividend paid to then shareholders and minority interests of $1.91 million.

Research and Development, Patents and Licenses, Etc.

Research and Development Efforts

As a high-technology company, our business and long-term development rely highly on our research and development capabilities. Our research and development process is based on Capability Maturity Model Integration Level 2&3 and can be classified into the following seven phases:

- Study phase
- Requirement phase
- Designing phase
- Implementation phase
- Testing Phase
- Inspection Phase
- Maintaining phase

We use standard project development life cycle models, including the waterfall model, increment model, iterative model and prototype. As a technology leader we continually develop and patent new automation technologies. We also continually review and evaluate technological changes affecting the automation and integrated system industries and invest substantially in application-based research and development. We currently employ over 490 staff in the research and development department or engaged in research and development work.

Our core technologies achieved from our research and development efforts include:

1. Large scale software platform architecture design;
2. Proprietary network design and development technologies;

3. Safety computer platform design and manufacturing;

4. Efficient I/O (Input/Output) signal processing design technology; and

5. Embedded system design and manufacturing.

We are committed to incorporating the latest advances in electronics and information system technology into its products and, whenever possible, developing state-of-the-art proprietary products based on its extensive internal expertise and research efforts. We currently spend approximately 3-6% of our annual revenues on research and development. Our recent major research and development focuses include:

- Process Control;
- Nuclear Power Automation System;

	2,701,792		2,701,792		---		
Operating expenses:							
Sales and marketing		1,030,870		1,030,870		---	
General and administrative		1,819,987		1,819,987		---	
Bad deb provision		29,650		29,650		---	
Depreciation and amortization		436,903		436,903		---	
Total operating expenses		3,317,410		3,317,410		---	
Loss from operations		(615,618)		(615,618)		---	
Other income		75		75		---	
Loss on valuation adjustment of derivatives		---		(874,992)		(874,992)	(a)
Other expenses, net		(289,876)		(289,876)		---	
Loss before income taxes		(905,419)		(1,780,411)		(874,992)	
Provision for income taxes		187,182		187,182		---	
Net loss	$	(718,237)	$	(1,593,229)	$	(874,992)	
Net loss per share:							
Basic	$	(0.02)	$	(0.03)	$	(0.01)	(b)
Diluted	$	(0.02)	$	(0.03)	$	(0.01)	(b)
Weighted average shares outstanding:							
Basic		48,619,855		48,619,855		---	
Diluted		48,619,855		48,619,855		---	

(a) Fair value adjustment on common stock warrants treated as derivatives under EITF 00-19.
(b) Decrease from effects of fair value adjustment of derivatives.

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Findex.com, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
Three Months Ended September 30, 2005
(Unaudited)

	As Originally Reported	As Restated	Change	
Revenues, net of reserves and allowances	$ 1,023,609	$ 1,023,609	$ ---	
Cost of sales	316,449	316,449	---	
Gross profit	707,160	707,160	---	
Operating expenses:				
Sales and marketing	295,902	295,902	---	
General and administrative	613,191	613,191	---	
Bad debt provision	6,981	6,981	---	
Depreciation and amortization	145,355	145,355	---	
Total operating expenses	1,061,429	1,061,429	---	
Loss from operations	(354,269)	(354,269)	---	
Other income	75	75	---	
Loss on valuation adjustment of derivatives	---	(328,121)	(328,121)	(a)
Other expenses, net	(164,101)	(164,101)	---	
Loss before income taxes	(518,295)	(846,416)	(328,121)	
Provision for income taxes	(111,976)	(111,976)	---	
Net loss	$ (630,271)	$ (958,392)	$ (328,121)	
Net loss per share:				
Basic	$ (0.01)	$ (0.02)	$ (0.01)	(b)
Diluted	$ (0.01)	$ (0.02)	$ (0.01)	(b)
Weighted average shares outstanding:				
Basic	48,619,855	48,619,855	---	
Diluted	48,619,855	48,619,855	---	

(a) Fair value adjustment on common stock warrants treated as derivatives under EITF 00-19.
(b) Decrease from effects of fair value adjustment of derivatives.

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Findex.com, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
Nine Months Ended September 30, 2004
(Unaudited)

	As Originally Reported	As Restated	Change	
Revenues, net of reserves and allowances	$ 3,526,492	$ 3,664,060	$ 137,568	(a)
Cost of sales	999,770	1,171,661	171,891	(b)
Gross profit	2,526,722	2,492,399	(34,323)	
Operating expenses:				
Sales and marketing	791,249	798,410	7,161	(c)
General and administrative	1,801,483	1,650,355	(151,128)	(d)
Nonrecurring items	186,965	---	(186,965)	(e)
Rebate reserve adjustment	(266,301)	---	266,301	(f)
Bad debt provision	11,066	11,066	---	
Depreciation and amortization	38,615	416,246	377,631	(g)
Total operating expenses	2,563,077	2,876,077	313,000	
Loss from operations	(36,355)	(383,678)	(347,323)	
Other income	9,135	1,010,288	1,001,153	(h)
Loss on valuation adjustment of derivatives	---	(1,385,422)	(1,385,422)	(k)
Other expenses, net	(38,285)	(193,344)	(155,059)	(l)
Loss before income taxes	(65,505)	(952,156)	(886,651)	
Provision for income taxes	15,700	(92,417)	(108,117)	(i)
Loss before extraordinary item	(49,805)	(1,044,573)	(994,768)	
Extraordinary item	763,162	---	(763,162)	(h)
Net income (loss)	$ 713,357	$ (1,044,573)	$ (1,757,930)	
Net earnings (loss) per share:				
Basic	$ 0.03	$ (0.03)	$ (0.06)	
Diluted	$ 0.02	$ (0.03)	$ (0.05)	
Weighted average shares outstanding:				
Basic	30,146,980	30,146,980	---	
Diluted	32,880,085	30,146,980	(2,733,105)	(j)

(a) Increase from reclassification of rebate reserve adjustment from Sales and marketing expenses and reclassify cost of estimated returns to Cost of sales.

(b) Increase from reclassification of non-capitalized technical support wages from General and administrative expenses, reclassification of fulfillment costs from Sales and marketing expenses, reclassification of Inventory write down expense from operating expenses, and reclassification of cost of estimated returns from net revenues.
(c) Increase from reclassification of rebate reserve adjustment to Revenues and reclassification of fulfillment costs to Cost of sales.
(d) Decrease from reclassification of non-capitalized technical support wages to Cost of sales and costs of withdrawn public offering to Other expenses, net.
(e) Decrease from reclassification of inventory write-down to Cost of sales.
(f) Increase from reclassification as an adjustment to revenue.
(g) Increase from effects of additional amortization of the software license agreement.
(h) Reclassification of debt forgiveness as other income from net extraordinary item.
(i) Income tax effects of additional software license amortization.
(j) Decrease due to correction of error in calculation of potentially dilutive common stock warrants.
(k) Fair value adjustment on common stock warrants treated as derivatives under EITF 00-19.
(l) Reclassification of costs of withdrawn public offering from General and administrative.

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Findex.com, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
Three Months Ended September 30, 2004
(Unaudited)

	As Originally Reported	As Restated	Change	
Revenues, net of reserves and allowances	$ 1,027,277	$ 1,010,207	$ (17,070)	(a)
Cost of sales	368,979	431,592	62,613	(b)
Gross profit	658,298	578,615	(79,683)	
Operating expenses:				
Sales and marketing	294,200	287,909	(6,291)	(c)
General and administrative	552,177	478,781	(73,396)	(d)
Nonrecurring items	154,569	---	(154,569)	(e)
Bad debt provision	8,566	8,566	---	
Depreciation and amortization	15,729	141,607	125,878	(f)
Total operating expenses	1,025,241	916,863	(108,378)	
Loss from operations	(366,943)	(338,248)	28,695	
Other income	8,019	1,010,288	1,002,269	(g)
Loss on valuation adjustment of derivatives	---	(1,385,422)	(1,385,422)	(h)
Other expenses, net	(6,651)	(162,826)	(156,175)	(e)
Loss before income taxes	(365,575)	(876,208)	(510,633)	
Provision for income taxes	18,005	(31,095)	(49,100)	(i)
Loss before extraordinary item	(347,570)	(907,303)	(559,733)	
Extraordinary item	763,162	---	(763,162)	(g)
Net income (loss)	$ 415,592	$ (907,303)	$ (1,322,895)	
Net earnings (loss) per share:				
Basic	$ 0.01	$ (0.02)	$ (0.03)	
Diluted	$ 0.01	$ (0.02)	$ (0.03)	
Weighted average shares outstanding:				
Basic	46,153,189	46,153,189	---	
Diluted	48,886,294	46,153,189	(2,733,105)	(j)

(a) Increase from reclassification of rebate reserve adjustment from Sales and marketing expenses and reclassify cost of estimated returns to Cost of sales.
(b) Increase from reclassification of non-capitalized technical support wages from General and administrative expenses, reclassification of fulfillment costs from Sales and marketing expenses, reclassification of Inventory write down expense from

operating expenses, and reclassification of cost of estimated returns from net revenues.
(c) Decrease from reclassification of fulfillment costs to Cost of sales.
(d) Decrease from reclassification of non-capitalized technical support wages to Cost of sales.
(e) Reclassification of expenses incurred in a withdrawn public offering to Other expenses, net.
(f) Increase from effects of additional amortization of the software license agreement.
(g) Reclassification of debt forgiveness as other income from net extraordinary item.
(h) Fair value adjustment on common stock warrants treated as derivatives under EITF 00-19.
(i) Income tax effects of additional software license amortization.
(j) Decrease due to correction of error in calculation of potentially dilutive common stock warrants.

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Findex.com, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2005
(Unaudited)

	As Originally Reported	As Restated	Change	
Cash flows from operating activities:				
Cash received from customers	$ 4,049,153	$ 4,049,153	$ ---	
Cash paid to suppliers and employees	(3,565,309)	(3,565,309)	---	
Other operating activities, net	(3,910)	(3,910)	---	
Net cash provided by operating activities	479,934	479,934	---	
Cash flows from investing activities:				
Software development costs	(766,151)	(766,151)	---	
Other investing activities, net	15,300	15,300	---	
Net cash (used) by investing activities	(750,851)	(750,851)	---	
Cash flows from financing activities:				
Payments made on long-term notes payable	(30,604)	(30,604)	---	
Net cash (used) by financing activities	(30,604)	(30,604)	---	
Net (decrease) in cash and cash equivalents	(301,521)	(301,521)	---	
Cash and cash equivalents, beginning of year	341,359	341,359	---	
Cash and cash equivalents, end of period	$ 39,838	$ 39,838	$ ---	
Reconciliation of net loss to cash flows from operating activities:				
Net loss	$ (718,237)	$ (1,593,229)	$ ($874,992)	(a)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:				
Software development costs amortized	524,989	524,989	---	

Loss on valuation adjustment of derivatives	---	874,992	874,992	(a)
Provision for bad debts	29,650	29,650	---	
Depreciation and amortization	436,903	436,903	---	
Loss on disposal of property and equipment	1,869	1,869	---	
Change in assets and liabilities:				
Decrease in accounts receivable	71,786	71,786	---	
Decrease in inventories	22,231	22,231	---	
Decrease in refundable income taxes	7,164	7,164	---	
Decrease in prepaid expenses	55,509	55,509	---	
Increase in accrued royalties	40,831	40,831	---	
Increase in accounts payable	65,858	65,858	---	
Increase in income taxes payable	180	180	---	
(Decrease) in deferred taxes	(187,362)	(187,362)	---	
Increase in other liabilities	128,563	128,563	---	
Net cash provided by operating activities	$ 479,934	$ 479,934	$ ---	

(a) Loss increase from fair value adjustment of derivatives.

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Findex.com, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2004
(Unaudited)

	As Originally Reported	As Restated	Change	
Cash flows from operating activities:				
Cash received from customers	$ 3,607,255	$ 3,607,255	$ ---	
Cash paid to suppliers and employees	(4,368,409)	(4,368,409)	---	
Other operating activities, net	(34,235)	(34,235)	---	
Net cash (used) by operating activities	(795,389)	(795,389)	---	
Cash flows from investing activities:				
Software development costs	(415,197)	(415,197)	---	
Other investing activities, net	(57,152)	(7,152)	50,000	(a)
Net cash (used) by investing activities	(472,349)	(422,349)	50,000	
Cash flows from financing activities:				
Proceeds from (payments on) line of credit, net	(20,933)	(20,933)	---	
Payments made on long-term notes payable	(202,551)	(202,551)	---	
Proceeds from convertible notes payable	240,000	240,000	---	
Stock offering costs paid	(51,047)	(51,047)	---	
Proceeds from issuance of common stock and warrants	1,750,000	1,750,000	---	
Net cash provided by financing activities	1,715,469	1,715,469	---	
Net increase in cash and cash equivalents	447,731	497,731	50,000	
Cash and cash equivalents, beginning of year	142,022	41,668	(100,354)	(a)
Cash and cash equivalents, end of period	$ 589,753	$ 539,399	$ (50,354)	

Reconciliation of net income (loss) to cash flows from operating activities:				
Net income (loss)	$ 713,357	$ (1,044,573)	$ (1,757,930)	
Adjustments to reconcile net income (loss)to net cash provided (used) by operating activities:				
Software development costs amortized	397,627	397,627	---	
Provision for bad debts	11,066	11,066	---	
Common stock and warrants issued for services	73,700	73,700	---	
Loss on valuation adjustment of derivatives	---	1,385,422	1,385,422	(d)
Rebate reserve adjustment	(266,301)	---	266,301	(c)
Depreciation and amortization	38,615	416,245	377,630	(b)
Extraordinary item	(1,000,662)	---	1,000,662	(e)
Debt foregiveness	---	(1,000,662)	(1,000,662)	(e)
Loss on disposal of property and equipment	141	141	---	
Change in assets and liabilities:				
Decrease in accounts receivable	57,887	57,887	---	
Decrease in inventories	109,800	109,800	---	
(Increase) in refundable income taxes payable	(2,948)	(2,948)	---	
(Increase) in prepaid expenses	(114,629)	(114,629)	---	
(Decrease) in accrued royalties	(381,677)	(381,677)	---	
(Decrease) in accounts payable	(407,683)	(407,683)	---	
(Decrease) in income taxes payable	(950)	(950)	---	
Increase in deferred taxes	220,316	90,931	(129,385)	(f)
(Decrease) in other liabilities	(243,048)	(385,086)	(142,038)	(c)
Net cash used by operating activities	$ (795,389)	$ (795,389)	$ ---	

(a) Reclassification of restricted cash held by merchant banker as other asset.
(b) Increase from additional software license amortization.
(c) Reclassification of Rebate reserve adjustment as decrease in other liabilities.
(d) Fair value adjustment on common stock warrants treated as derivatives under EITF 00-19.
(e) Reclassify extraordinary item as debt forgiveness.
(f) Net income tax effects of additional software amortization.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

Cautionary Statement Regarding Forward-Looking Statements

This Form 10-QSB, press releases and certain information provided periodically in writing or orally by our officers or our agents contain statements which constitute forward-looking statements. The words "may", "would", "could", "will", "expect", "estimate", "anticipate", "believe", "intend", "plan", "goal" and similar expressions and variations thereof are intended to specifically identify forward-looking statements. These statements appear in a number of places in this Form 10-QSB and include all statements that are not statements of historical fact regarding the intent, belief or current expectations of us, our directors or our officers, with respect to, among other things (i) our liquidity and capital resources, (ii) our financing opportunities and plans, (iii) our ability to attract customers to generate revenues, (iv) market and other trends affecting our future financial condition or results of operations, (v) our growth strategy and operating strategy, and (vi) the declaration and/or payment of dividends.

Investors and prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors. The factors that might cause such differences include, among others, those set forth in Part I, Item 2 of this quarterly report on Form 10-QSB, entitled Management's Discussion and Analysis or Plan of Operation, including without limitation the risk factors contained in the company's annual report on Form 10-KSB/A for the period ending December 31, 2004. Except as required by law, we undertake no obligation to update any of the forward-looking statements in this Form 10-QSB after the date of this report.

This information should be read in conjunction with the financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report and the audited financial statements and notes thereto and Management's Discussion and Analysis or Plan of Operation contained in the company's Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2004.

MANAGEMENT OVERVIEW

During the third quarter of 2005, we released an upgrade to our flagship product, QuickVerse®, which was three months earlier compared to our upgrade release of QuickVerse® in 2004. Furthermore, this is the first upgrade release of QuickVerse® in over five years that will be in the retail stores before the Holiday season begins. QuickVerse® 2006 is currently available in five editions, QuickVerse® 2006 Essentials, QuickVerse® 2006 Standard, QuickVerse® 2006 Expanded, QuickVerse® 2006 Deluxe and QuickVerse® 2006 Platinum. We believe that the unique features of the new QuickVerse®2006 editions will provide us with an opportunity to broaden our customer base as our products appeal not only to those just beginning their journey into Bible study but also to the scholars who are searching for an in-depth knowledge of the Bible. The QuickVerse® 2006 editions range in retail price from $49.95 to $799.95. In addition, during the second quarter of 2005 and for the first time in our operating history, we introduced QuickVerse® to the Macintosh® Operating System platform. QuickVerse®Macintosh is available in two new editions, QuickVerse® Macintosh Black which has a suggested retail price of $99.95 and QuickVerse®Macintosh White which has a suggested retail price of $49.95. We believe we are now the only publisher of Bible reference software for each of the Windows®, Macintosh®, PocketPC® and Palm® OS platforms. We also released an updated version of Bible Illustrator® 3.0 titled Sermon Builder® 4.0 during the second quarter of 2005. Sermon Builder® 4.0 was the first update to this particular program in over six years and has a suggested retail price of $69.95. Sermon Builder® 4.0 is ideal for pastors and teachers who want to create punctuated sermons, comprehensive lessons, and in-depth Bible studies. Furthermore, during the first quarter of 2005, and for the second consecutive year, we released an upgrade to our top-selling financial and data management software, Membership Plus®, and introduced two new QuickVerse® editions, QuickVerse® 2005 Essentials and QuickVerse® 2005 Platinum. As a result of these releases, our third quarter

2005 revenues were higher than those during the third quarter of 2004. Although there can be no assurance, we believe that we can sustain our revenue growth through the fourth quarter based upon our development schedule which includes an update to our QuickVerse® PDA software.

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Results Of Operations for Quarters Ending September 30, 2005 and September 30, 2004

Statement of Operations for Nine Months Ended September 30	**2005**	2004	Change	%
Net revenues	**$ 3,978,019**	$ 3,664,060	$ 313,959	9%
Cost of sales	**$ 1,276,227**	$ 1,171,661	$ 104,566	9%
Gross profit	**$ 2,701,792**	$ 2,492,399	$ 209,393	8%
Total operating expenses	**$ (3,317,410)**	$ (2,876,077)	$ (441,333)	15%
Other income	**$ 75**	$ 1,010,288	$ (1,010,213)	-100%
Loss on valuation adjustment of derivatives	**$ (874,992)**	$ (1,385,422)	$ 510,430	-37%
Other expenses	**$ (289,876)**	$ (193,344)	$ (96,532)	50%
Loss before income taxes	**$ (1,780,411)**	$ (952,156)	$ (828,255)	87%
Provision for income taxes	**$ 187,182**	$ (92,417)	$ 279,599	-303%
Net loss	**$ (1,593,229)**	$ (1,044,573)	$ (548,656)	53%

Our software products are highly seasonal. More than 50% of our annual sales are expected to occur in the five months of September through January; the five months of April through August are generally our weakest, generating only about 29% of our annual sales.

For the nine months ended September 30, 2004, we wrote down the reserve for rebates payable from a change in accounting estimate of approximately $142,000 and wrote down actual rebates payable of approximately $61,000 due to an overstatement. Both of these write down items are recognized as an adjustment to revenue. We also wrote down a distinct category of obsolete inventory of approximately $32,000 which is included in cost of sales, and incurred an expense of approximately $155,000 related to a settlement with an institutional private equity investor which is included in other expenses. Furthermore, for the nine months ended September 30, 2004, we recognized approximately a $1,000,000 gain from extinguishment of debt which is classified as other income. The extinguishment of debt is a direct result of our settling with various vendors and content providers for lump-sum payments at a reduced amount of balances owed. We recognized a loss of approximately $1,385,000 for the nine months ended September 30, 2004 and a loss of approximately $875,000 for the nine months ended September 30, 2005 related to the fair value adjustment of derivatives in other expenses. Warrants issued with shares of common stock in a private placement are considered derivative liabilities. The derivative liability associated with the warrants has been adjusted to fair value at each balance sheet date and is accordingly reassessed at each such time to determine whether the warrants should be classified (or reclassified, as appropriate) as a liability or as equity. See “Derivatives” below. For the nine months ended September 30, 2005, we incurred penalties of approximately $278,000 in connection with a certain Registration Rights Agreement entered into with Barron Partners, LP and our registration statement on Form SB-2 originally filed on November 22, 2004, and which, as of the date of this filing, has yet to be declared effective. These penalties are included in other expenses. Furthermore, due to the continued delays in effectiveness of such registration statement, due principally to ongoing efforts made necessary by our determination to restate certain of our historical financial information, we have experienced an increase in legal expenses of approximately $136,000 for the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004. Due mainly to the items stated above, our net loss increased approximately $51,000 from a net loss of approximately $907,000 for the three months ended September 30, 2004 to a net loss of approximately $958,000 for the three months ended September 30, 2005 and increased approximately $548,000 from a net loss of approximately $1,045,000 for the nine months ended September 30, 2004 to a net loss of approximately $1,593,000 for the nine months ended September 30, 2005.

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Revenues

We derive revenues from the sale of packaged software products, product support and multiple element arrangements that may include any combination of these items. Revenue is recognized when persuasive evidence of an arrangement exists (generally a purchase order), we have delivered the product, the fee is fixed or determinable and collectibility is probable. For our packaged software products, we typically recognize revenue from the sale when we ship the product. We sell some of our products on consignment to a limited number of resellers. We recognize revenue for these consignment transactions only when the end-user sale has occurred. Service revenue resulting from technical support plans is recognized over the life of the plan which is generally one year. Revenue associated with advance payments from our customers is deferred until we ship the product or offer the support service. Revenue for software distributed electronically via the Internet is recognized when the customer has been provided with the access codes that allow the customer to take immediate possession of the software on its hardware and evidence of the arrangement exists. For revenue arrangements involving multiple elements and include software products, we allocate and defer revenue for the undelivered elements based on their vendor-specific objective evidence of fair value, which is generally the price charged when that element is sold separately.

We reduce product revenue for estimated returns and price protections that are based on historical experience and other factors such as the volume and price mix of products in the retail channel, trends in retailer inventory and economic trends that might impact customer demand for our products. Estimated returns are also based upon a percentage of total retail and direct sales. Direct sales accounted for approximately 65% of our 2004 fiscal year revenue. We account for cash considerations (such as sales incentives - rebates and coupons) that we give our customers as a reduction of revenue rather than as an operating expense. Product revenue is also reduced for the estimated redemption of end-user rebates on certain current product sales. We did not have any rebate programs during the three and nine months ended September 30, 2004 and 2005, respectively.

Trends that our returns typically follow include (i) the seasonality of sales, and (ii) the fact that, generally, relatively higher return rates occur during periods of new title or title version releases. Historically, actual returns have been within management's prior estimates, however, we cannot be certain that any future write-offs exceeding reserves will not occur or that amounts written off will not have a material adverse effect on our business, our financial condition, including liquidity and profitability, and our results of operations. Management continually monitors and adjusts these allowances to take into account actual developments and sales results in the marketplace. In the past, particularly during title and title version transitions, we have had to increase price concessions to our retail customers.

Product returns from distributors and Christian bookstores are allowed primarily in exchange for new products or for credit towards purchases as part of a stock-balancing program. These returns are subject to certain limitations that may exist in the contract. Under certain circumstances, such as termination or when a product is defective, distributors and bookstores could receive a cash refund if returns exceed amounts owed. Returns from sales made directly to the consumer are accepted within 45 days of purchase and are issued a cash refund. Product returns or price protection concessions that exceed our reserves could materially adversely affect our business and operating results and could increase the magnitude of quarterly fluctuations in our operating and financial results. We did implement a price protection program within the third quarter of 2005 on our QuickVerse® 2005 titles within the Christian Booksellers Association retail channel due to our updated release of QuickVerse® 2006. QuickVerse® 2006 was released in late September 2005, and we believe we reserved appropriately for the price protections.

Software products are sold separately, without future performance such as upgrades enhancements or additional software products, and are sold with post contract customer support services such as customer service and technical support assistance. In connection with the sale of certain products, we provide a limited amount of free technical support assistance to our customers. We do not defer the recognition of any revenue associated with sales of these products, since the cost of providing this free technical support is insignificant. The technical support is provided within one year after the associated revenue is recognized and free product enhancements (bug fixes) are minimal and infrequent. We accrue the estimated cost of providing this free support upon product shipment and include it in cost of sales.

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Shipping and handling costs in connection with our software products are expensed as incurred and included in cost of sales.

Revenues for Three Months Ended September 30	**2005**	**% to Sales**	2004	% to Sales	Change	%
Gross sales	**$ 1,233,389**	**100%**	$ 1,125,275	100%	$ 108,114	10%
Add rebate adjustment	**4,910**	**---%**	---	---%	4,910	---%
Less reserve for sales returns and allowances	**(214,691)**	**-17%**	(115,068)	-10%	(99,623)	87%
Net sales	**$ 1,023,609**	**83%**	$ 1,010,207	90%	$ 13,401	1%

Revenues for Nine Months Ended September 30	**2005**	**% to Sales**	2004	% to Sales	Change	%
Gross sales	**$ 4,744,759**	**100%**	$ 3,898,250	100%	$ 846,510	22%
Add rebate adjustment	**14,730**	**---%**	202,548	5%	(187,817)	-93%
Less reserve for sales returns and allowances	**(781,471)**	**-16%**	(436,737)	-11%	(344,733)	79%
Net sales	**$ 3,978,019**	**84%**	$ 3,664,060	94%	$ 313,959	8%

Gross revenues increased approximately $108,000 from approximately $1,125,000 for the three months ended September 30, 2004 to approximately $1,233,000 for the three months ended September 30, 2005 and increased approximately $847,000 from approximately $3,898,000 for the nine months ended September 30, 2004 to approximately $4,745,000 for the nine months ended September 30, 2005. Such increase is due to our releases during the nine months ended September 30, 2005 including an enhanced version of our top financial and data management product, Membership Plus®, an enhanced version of QuickVerse® 2005 Essentials and QuickVerse® 2005 Platinum edition during the first quarter of 2005. During the second quarter of 2005, we introduced QuickVerse® Macintosh in two editions, White Box edition at the retail price of $49.95 and Black Box edition at the retail price of $99.95. This was our first product release on the Macintosh® Operating System platform. We also released an enhanced version of Bible Illustrator® 3.0 titled Sermon Builder® 4.0 during the second quarter of 2005. This was the first update to this program in over six years and retails for $69.95. During the third quarter of 2005, we released an upgrade to our flagship product, QuickVerse®, three months earlier compared to our upgrade release of QuickVerse® in 2004. QuickVerse® 2006 is the first upgrade release in over five years that will be in the retail stores prior to the beginning of the Holiday season. The five QuickVerse® 2006 editions that are currently available are QuickVerse® 2006

Essentials, QuickVerse® 2006 Standard, QuickVerse® 2006 Expanded, QuickVerse® 2006 Deluxe and QuickVerse® 2006 Platinum, and they range in retail price from $49.95 to $799.95. Comparatively, during the nine months ended September 30, 2004, we had only two product releases which included Membership Plus® 8.0 with a retail price of $199.95 to $299.95 and QuickVerse® 2005 PDA with a retail price of $14.95 to $39.95. We anticipate that revenues will continue to increase throughout the year as the QuickVerse® 2006 editions reach the retail stores in time for the Holiday season and we will be releasing an update to our QuickVerse® PDA software within the fourth quarter of 2005.

Sales returns and allowances increased approximately $100,000 from approximately $115,000 for the three months ended September 30, 2004 to approximately $215,000 for the three months ended September 30, 2005 and increased approximately $345,000 from approximately $437,000 for the nine months ended September 30, 2004 to approximately $782,000 for the nine months ended September 30, 2005. As a percentage of gross sales, sales returns and allowances increased from approximately 10% for the three months ended September 30, 2004 to approximately 17% for the three months ended September 30, 2005 and increased from approximately 11% for the nine months ended September 30, 2004 to approximately 16% for the nine months ended September 30, 2005. The upward trend in sales returns and allowances as a percentage is attributable to our release of enhanced versions of QuickVerse® in December 2004 and late September 2005 and Membership Plus® in February of 2005. The release of these enhanced products resulted in an increased quantity of sales returns and allowances, such as price protections, of prior versions as the enhancements for both of these titles are approximately one year. In the past, product enhancements were typically extended over two to three years. We have also increased our reserve for sales returns due to a higher price point in connection with QuickVerse® Platinum being released in the first quarter of 2005. Furthermore, due to the resignation of the primary developer of Membership Plus® and some unresolved maintenance issues, we have experienced higher actual returns on the Membership Plus® 2005 product line. However, we are currently utilizing both domestic and international contracted developers to not only resolve the maintenance issues but to also continue the development for our annual update on the Membership Plus® program. We are on track to continue to release enhanced versions of our products on an annual basis; however, we do anticipate the sales return and allowances as a percentage to follow a downward trend in the future due to the increased focus of our sales efforts to the end-user and our decreased presence in the retail market. Incidents of return are lower for sales direct to the end-user than sales into the retail stores.

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Cost of Sales

Cost of sales consists primarily of royalties to third party providers of intellectual property and the direct costs and manufacturing overhead required to reproduce, package, fulfill and ship the software products. Direct costs and manufacturing overhead also include the amortized software development costs and the non-capitalized technical support wages. The direct costs and manufacturing overhead decreased approximately $21,000 from approximately $274,000 for the three months ended September 30, 2004 to approximately $253,000 for the three months ended September 30, 2005 and increased approximately $77,000 from approximately $899,000 for the nine months ended September 30, 2004 to approximately $976,000 for the nine months ended September 30, 2005. As a percentage of gross revenues, the direct costs and manufacturing overhead decreased approximately 4% for the three months ended September 30, 2005 and decreased approximately 2.5% for the nine months ended September 30, 2005. The nine months ended September 30, 2004 include the write down of a distinct category of obsolete inventory of approximately $32,000. Fulfillment costs from a third-party warehouse and included in the manufacturing overhead costs noted above decreased approximately $8,000 from approximately $53,000 for the nine months ended September 30, 2004 to approximately $45,000 for the nine months ended September 30, 2005 as we moved our retail fulfillment to a new outside entity in late October 2004. The decrease in the percentage of cost of sales reflects the continual software development cycle of enhancing our two major product lines within a one year timeframe and the increased amortization of those software development costs. The amortization recognized during the nine months ended September 30, 2004 resulted from several new software releases in late 2003 and early 2004 including QuickVerse® 8.0 and Membership Plus® 8.0. Similarly, the amortization recognized during the nine months ended September 30, 2005 resulted from the December 2004 release of QuickVerse® 2005, the February 2005 release of Membership Plus® 2005, the June 2005 releases of QuickVerse® Macintosh and Sermon Builder® 4.0, the late September 2005 release of QuickVerse® 2006 and the remainder of QuickVerse® 8.0 and Membership Plus® 8.0. The direct costs and manufacturing overhead percentage are expected to continue at the 2005 levels as working capital remains more consistent and as more development projects are implemented in a shortened timeframe.

Royalties to third party providers of intellectual property decreased approximately $94,000 from approximately $158,000 for the three months ended September 30, 2004 to approximately $64,000 for the three months ended September 30, 2005 and increased approximately $27,000 from approximately $273,000 for the nine months ended September 30, 2004 to approximately $300,000 for the nine months ended September 30, 2005. As a percentage of gross revenues, royalties decreased from approximately 14% for the three months ended September 30, 2004 to approximately 5% for the three months ended September 30, 2005 and slightly decreased from approximately 7% for the nine months ended September 30, 2004 to approximately 6.3% for the nine months ended September 30, 2005. The decrease of royalties for the three months ended September 30, 2004 and 2005 reflects the sale of some of the older QuickVerse® versions to liquidators at a reduced price in 2004 compared to no sales to liquidators during the same three month period in 2005. However, the overall steady percentage for the nine months ended September 30, 2004 and 2005 reflects the release of the QuickVerse® 2005 editions in early December 2004, and the three additional QuickVerse® editions, specifically QuickVerse® Essentials and QuickVerse® Platinum, which were released in early March of 2005 and QuickVerse® Macintosh which was released in June 2005. We also released Sermon Builder® 4.0 in June 2005 which was an update to Bible Illustrator® 3.0. This was the first update to Bible Illustrator® 3.0 in over six years and included not only technological updates but content additions. During the year ended 2004, we renegotiated several royalty contracts which resulted in some cases in a higher royalty rate along with access to more content. The royalty rate for the fourth quarter of 2005 is expected to increase as the QuickVerse® 2006 retail products began to ship in early October 2005 compared to the QuickVerse® 2005 retail products shipping in December 2004. In addition, the royalty rate as a percentage of gross sales is expected to increase in the future as sales to new users are expected to increase and as more development projects are implemented for new and/or enhanced products. However, upgrade sales will continue to be subject to royalties only on content additions of the upgraded version.

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Software development costs are expensed as incurred until technological feasibility and marketability has been established, at which time development costs are capitalized until the software title is available for general release to customers. Development costs include direct production costs (including labor directly associated with the development projects), indirect costs (including allocated fringe benefits, payroll taxes, facilities costs and management supervision), and other direct costs (including costs of outside consultants, purchased software to be included in the software product being developed, travel expenses, material and supplies, and other direct costs). Software development is segregated by title and technology platform. Once a product has been successfully released, subsequent revisions and upgrades are considered development and the costs of the revision and upgrade are capitalized. Capitalized costs are amortized on a product-by-product basis using the greater of (i) the straight-line amortization over the estimated life of the product (generally from 12 to 18 months), or (ii) the ratio of current revenues from the product to the total projected revenue over the life of the product. Generally, we consider technological feasibility to have been established with the release of a beta version for testing.

Software development costs are summarized in the table below. The software development costs, consisting primarily of direct and indirect labor and related overhead charges, capitalized during the three months ended September 30, 2004 and 2005 were approximately $237,000 and approximately $172,000, respectively and approximately $415,000 and $766,000 for the nine months ended September 30, 2004 and 2005, respectively. Accumulated amortization of these development costs included in cost of sales totaled approximately $139,000 and approximately $161,000 for the three months ended September 30, 2004 and 2005, respectively and approximately $398,000 and $525,000 for the nine months ended September 30, 2004 and 2005, respectively. The overall increase in both the capitalization and amortization is a direct result of the increase in the number of development projects we have undertaken in the last two years and the consistent one year turn around on enhanced versions of our two major product lines QuickVerse® and Membership Plus®.

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2005	2004	**2005**	2004
Beginning balance	**$ 931,103**	$ 504,497	**$ 701,289**	$ 584,706
Capitalized	**171,990**	237,148	**766,151**	415,196
Amortized (Cost of sales)	**160,642**	139,369	**524,989**	397,626
Ending Balance	**$ 942,451**	$ 602,276	**$ 942,451**	$ 602,276
Research and development expense (General and administrative)	**$ 63,164**	$ 532	**$ 130,407**	$ 44,228

Sales, General and Administrative

Sales, General and Administrative Costs for Nine Months Ended September 30	**2005**	**% to Sales**	2004	% to Sales	Change	%
Selected expenses:						
Commissions	**$ 611,653**	**13%**	$ 576,482	15%	$ 35,171	6%
Advertising and direct marketing	**419,217**	**9%**	221,928	6%	197,288	89%
	$ 1,030,870	**22%**	$ 798,410	20%	$ 232,459	29%

Total sales and marketing						
Research and development	**$ 130,407**	**3%**	$ 44,228	1%	$ 86,180	195%
Personnel costs	**973,620**	**21%**	946,222	24%	27,398	3%
Legal	**157,970**	**3%**	21,742	1%	136,228	627%
Telecommunications	**42,605**	**1%**	107,720	3%	(65,115)	-60%
Corporate services	**73,972**	**2%**	53,965	1%	20,007	37%
Administration	**13,263**	**0%**	101,756	3%	(88,493)	-87%
Other general and administrative costs	**428,150**	**9%**	374,723	10%	53,427	14%
Total general and administrative	**$ 1,819,987**	**38%**	$ 1,650,355	42%	$ 169,632	10%

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Gross revenues increased approximately $108,000 from approximately $1,125,000 for the three months ended September 30, 2004 to approximately $1,233,000 for the three months ended September 30, 2005 and increased approximately $847,000 from approximately $3,898,000 for the nine months ended September 30, 2004 to approximately $4,745,000 for the nine months ended September 30, 2005. However, sales and marketing expenses also increased approximately $8,000 from approximately $288,000 for the three months ended September 30, 2004 to approximately $296,000 for the three months ended September 30, 2005 and increased approximately $233,000 from approximately $798,000 for the nine months ended September 30, 2004 to approximately $1,031,000 for the nine months ended September 30, 2005. Included in sales expenses, commissions to a third-party telemarketing firm increased approximately $35,000 from approximately $577,000 for the nine months ended September 30, 2004 to approximately $612,000 for the nine months ended September 30, 2005. This increase is attributed to the increased focus of our sales to the direct consumer along with the number of new and enhanced product releases during the nine months ended September 30, 2005 compared with two product releases during the nine months ended September 30, 2004. However, as a percentage of gross revenues commissions decreased from approximately 15% to approximately 13% for the nine months ended September 30, 2004 and 2005, respectively. This decrease is attributed to the in-house development of our direct telemarketing sales team as we attempt to reduce the reliance on the third-party telemarketing firm. Advertising and direct marketing costs increased approximately $197,000 from approximately $222,000 for the nine months ended September 30, 2004 to approximately $419,000 for the nine months ended September 30, 2005 and increased as a percentage of gross revenues from approximately 6% to approximately 9%, respectively. This increase is a direct result in continuing to market our products online through multiple sources, continuing to increase and focus more on our direct marketing efforts, and the increased number of publication advertisements due to the new product enhancements of QuickVerse® 2006 and Membership Plus® 2005 along with the introduction of the three new QuickVerse® editions (QuickVerse® Platinum, Macintosh and Essentials) and the updated Sermon Builder® 4.0 during the nine months ended September 30, 2005.

Research and development costs include direct production costs (including labor directly associated with the development projects), indirect costs (including allocated fringe benefits, payroll taxes, facilities costs and management supervision), and other direct costs (including costs of outside consultants, purchased software to be included in the software product being developed, travel expenses, material and supplies, and other direct costs). Software development costs related to third-party developers and direct labor expensed as research and development (see table above) amounted to approximately $500 for the three months ended September 30, 2004 compared to approximately $63,000 incurred for the three months ended September 30, 2005 and approximately $44,000 for the nine months ended September 30, 2004 compared to approximately $130,000 for the nine months ended September 30, 2005. The increase in 2005 reflects more research and development costs associated with maintenance issues on titles after they are released to the general public along with exploring new platforms for future products. Research and development expenses are expected to increase in future periods as we add new products and versions to our product mix along with new platforms for our current and future products.

Total personnel costs increased approximately $27,000 from approximately $946,000 for the nine months ended September 30, 2004 to approximately $973,000 for the nine months ended September 30, 2005. However, direct salaries and wages increased approximately $115,000 from approximately $1,083,000 for the nine months ended September 30, 2004 to approximately $1,198,000 for the nine months ended September 30, 2005. As a percentage of gross revenues, direct salaries and wages decreased approximately 2.5% from approximately 27.8% for the nine months ended September 30, 2004 to approximately 25.3% for the nine months ended September 30, 2005. The direct salaries and wages include approximately $36,000 and $-0- in expense for upper management year-end bonus accrual for the year ends December 31, 2004 and 2005, respectively. Furthermore, we recognized approximately $14,000 of expense related to 635,000 restricted common shares issued to employees during the nine months ended September 30, 2004. The increase in direct salaries and wages is a direct result of increasing our sales and marketing team, our development staff and our direct telemarketing sales team. The associated health care costs decreased approximately $16,000 from approximately $121,000 for the nine months ended September 30, 2004 to approximately $105,000 for the nine months ended September 30, 2005 as we restructured our health benefits plans in late October 2004. The capitalization of direct and indirect labor and related overhead charges as software development costs (see “Cost of Sales” above) increased by approximately $155,000 from approximately $206,000 for the nine months ended September 30, 2004 to approximately $361,000 for the nine months ended September 30, 2005. This increase is due to the addition of development staff and the increased amount of new development projects. It is anticipated that personnel costs will increase in future periods as operating capital is available to fund full staffing of our product development team and expansion of the direct sales staff.

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Direct legal costs increased approximately $136,000 for the nine months ended September 30, 2005 as the company continues to work through the registration process for the SB-2 registration statement. It is anticipated that legal costs will continue at increased levels as we pursue our business plan for growth by acquiring companies that are synergistic with our current product line and customer base. Telecommunications costs decreased approximately $65,000 for the nine months ended September 30, 2005 as we switched our local and long distance carriers in order to take advantage of the provider's current technology. Our increased call volume enabled us to change our service to dedicated T-1 lines which in turn reduced the long distance charges. Furthermore, we invested in internet protocol phones for our remote locations which reduced the overall local and long distance charges in our Illinois and Iowa locations. The increased call volume in the technical support and customer service departments resulted from the release of the two major product upgrades in December 2004 and February 2005 along with the three new product releases during the nine months ended September 30, 2005. Corporate service fees increased approximately $20,000 for the nine months ended September 30, 2005. These fees are related to the hiring of an outside consultant and the expense for a 2004 issuance of a warrant to purchase 600,000 shares of common stock allocated over the term of the consulting contract. Administration expenses decreased approximately $88,000 for the nine months ended September 30, 2005 due to not incurring interest and penalty fees on back payroll taxes as we did during the nine months ended September 30, 2004. Finally, bad debt expense increased approximately $19,000 for the nine months ended September 30, 2005 as we were notified by one of our liquidation customers of the possibility that they will not be able to pay on their full balance due to us.

Other Income and Expenses

During the quarter ended September 30, 2004, we recognized an approximately $1,000,000 gain from extinguishment of debt which is included in other income. The extinguishment of debt is a direct result from one-time settlement arrangements with various vendors and content providers for lump-sum payments ranging from approximately 17% to approximately 60% of balances owed at the time. Vendors who were offered the settlement had previously provided services and/or goods to us, and the content providers were owed royalties from us. We do not anticipate this to be a recurring event in the future.

Furthermore during the quarter ended September 30, 2004, we incurred approximately $155,000 in expenses related to a settlement agreement with Swartz Private Equity, an institutional private equity investor, for early termination of the agreement. As part of a settlement agreement, we issued 295,692 shares of common stock and paid a cash lump sum of $125,000. The shares were valued at $0.10 per share. This has been included in other expenses.

On July 19, 2004, we completed an equity financing in the amount of $1,750,000 through a private placement with Barron Partners, LP where Barron Partners purchased 21,875,000 restricted shares of common stock and received two warrants to purchase up to an additional 21,875,000 shares of common stock. As part of the financing transaction, we also entered into a certain Registration Rights Agreement with Barron Partners pursuant to which we became committed to registering all of the shares issued as part of such transaction, including those issuable under the warrants.

Upon receipt of the requisite stockholder approval to increase the number of authorized common shares so as to allow us to deliver the warrants, effectively obtained and effectuated as of November 10, 2004, we had 30 days within which to file a registration statement on Form SB-2 covering the shares issued to Barron Partners, as well as the shares underlying the warrants issued to Barron Partners. Such registration statement was filed on November 22, 2004. In accordance with the terms of the Registration Rights Agreement, as amended, we had another 150 days, until April 22, 2005, to cause such registration statement to be declared effective by the SEC, with any delays in meeting this obligation resulting in our being liable to Barron Partners in an amount equal to $630,000 per year, pro-rated for the duration of any such delay, which amounts to $1,726 per day.

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As of September 30, 2005, we had accrued a total of $278,000 (161 days at $1,726 per day) in penalties under the terms of the Registration Agreement, inclusive of an adjustment made pursuant to a tentative verbal agreement reached with Barron Partners in April 2005, wherein, in relation to the associated accruing penalties, we agreed to pay Barron Partners an amount in cash equal to $100,000 to toll the accrual of further penalties until June 21, 2005. Although this amount has been paid in full, in two equal installments of $50,000 on each of April 22, 2005 and July 8, 2005, penalties in the amount of $1,726 per day continue to accrue from June 21, 2005 until the registration statement is declared effective, at which time a negotiated reduction of such total amount is expected to be reached, the extent of which is as yet unknown, and terms of payment of which are expected to be agreed to so as to allow us to reasonably meet our ongoing operating needs. The penalties have been included in other expenses. We have experienced continued delays in effectiveness of the registration statement due principally to ongoing efforts made necessary by our determination to restate certain of our historical financial information. Although there can be no assurance, management is hopeful that we will cause such registration statement to be declared effective in the near future. The amount paid by us to date to satisfy this obligation has, and any continued delays in our ability to cause the registration statement to be declared effective coupled with additional amounts which we are and may be required to pay, will have a material adverse effect on our business, our financial condition, including liquidity and profitability, and our results of operations, including a corresponding reduction in our net income and the likelihood of a net loss for the year.

Derivatives

In November 2004, we issued two warrants to purchase an aggregate of 21,875,000 shares of our common stock in connection with a certain Stock Purchase Agreement completed with Barron Partners, LP, on July 19, 2004. The first warrant entitles the holder to purchase up to 10,937,500 shares of our common stock at a price of $0.18 per share, and the second warrant entitles the holder to purchase up to 10,937,500 additional shares of our common stock at a price of $0.60 per share. Each warrant is subject to standard adjustment provisions and each provides for settlement in registered shares of our common stock and may, at the option of the holder, be settled in a cashless, net-share settlement. These warrants have been accounted for as a liability according to the guidance of EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.* In accordance with accounting mandate, the derivative liability associated with these warrants has been and shall continue until our registration statement on Form SB-2 originally filed on November 22, 2004 is declared effective to be adjusted to fair value at each balance sheet date and is accordingly reassessed at each such time to determine whether the warrants should be classified (or reclassified, as appropriate) as a liability or as equity. The fair value of each warrant was initially assessed at $2,187,500 ($4,375,000 total) using the Black-Scholes valuation method. At September 30, 2004 and September 30, 2005, the fair value of the derivative liability was approximately $3,063,000 and approximately $2,844,000, respectively, and a fair value adjustment of approximately $1,385,000 and approximately $875,000, respectively, has been included in other expenses for the nine months then ended.

Amortization

Amortization expense increased approximately $12,000 for the nine months ended September 30, 2005. The software license acquired from The Learning Company in July of 1999 is amortized over a 10 year useful life. Amortization expense for 2005 reflects the continual amortization of the software license along with the amortization for the launch of our website, www.quickverse.com, during the second quarter of 2004.

Income Tax Benefits

Our effective tax rate differs from the statutory federal rate due to differences between income and expense recognition prescribed by the Internal Revenue Code and Generally Accepted Accounting Principles. We utilize different methods and useful lives for depreciating property and equipment. Changes in estimates (reserves) are recognized as expense for financial reporting but are not deductible for income tax purposes.

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We have recognized a net deferred tax asset whose realization depends on generating future taxable income. At September 30, 2005, management established the valuation allowance based on the assessment that the company will produce sufficient income in the future to realize its net deferred tax asset. The resulting deferred tax liability reflects income taxes payable in future periods on the net deductible differences related to the software license agreement. We currently have net operating loss carryforwards, for income tax purposes, of approximately $7,648,000. The carryforwards are the result of income tax losses generated in 2000 ($2,480,000 expiring in 2020) and 2001 ($5,168,000 expiring in 2021). We will need to achieve a minimum annual taxable income over the remaining life of the carryforward, before deduction of operating loss carryforwards, of approximately $450,000 to fully utilize the current loss carryforwards. We believe this is achievable through careful expense management and continued introduction of new products and enhanced versions of our existing products.

Although there can be no assurance, management expects the deductible temporary differences (reserves) to reverse sometime beyond the next fiscal year.

Liquidity And Capital Resources

Our primary needs for liquidity and capital resources are the funding of our continued operations, which includes the ongoing internal development of new products and expansion and upgrade of existing products. We believe our future cash provided by operations will be sufficient to fund our continued operations. However, our pursuit of future strategic product line and/or corporate acquisitions and licensing will require funding from outside sources. Funding from outside sources may include but are not limited to the exercise of outstanding warrants and pursuit of other financing options such as commercial loans, common stock and/or preferred stock issuances and convertible notes. At this time, we have no legally committed funds for future capital expenditures including software development.

Working Capital at September 30	**2005**	2004	Change	%
Current assets	**$ 1,025,946**	$ 1,138,544	$ (112,598)	-10%
Current liabilites	**$ 4,438,500**	$ 4,395,404	$ 43,096	1%
Retained deficit	**$ (7,764,059)**	$ (8,179,456)	$ 415,397	-5%

As of September 30, 2005, we had $1,025,946 in current assets, $4,438,500 in current liabilities and a retained deficit of $7,764,059. We had a loss before income taxes of $846,416 for the three months ended September 30, 2005 and a loss before income taxes of $1,780,411 for the nine months ended September 30, 2005. In comparison, we had a loss before income taxes of $876,208 for the three months ended September 30, 2004 and a loss before income taxes of $952,156 for the nine months ended September 30, 2004.

Cash Flows for Nine Months Ended September 30	**2005**	2004	Change	%
Cash flows provided (used) by operating activities	**$ 479,934**	$ (795,389)	$ 1,275,323	-160%
Cash flows (used) by investing activities	**$ (750,851)**	$ (422,349)	$ (328,502)	78%
Cash flows provided (used) by financing activities	**$ (30,604)**	$ 1,715,469	$ (1,746,073)	-102%

Net cash used by operating activities was approximately $795,000 for the nine months ended September 30, 2004, and net cash provided by operating activities was approximately $480,000 for the nine months ended September 30, 2005. The increase in cash provided was primarily due to an increase in the amounts received from customers resulting from increased sales along with a decrease in the amount paid out to suppliers and employees.

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Net cash used in investing activities was approximately $422,000 for the nine months ended September 30, 2004 and approximately $751,000 for the nine months ended September 30, 2005. The increase in cash used for investing activities results from capitalizing costs associated with software development and Website development along with upgrading our internal computer equipment and software in order to increase our operating efficiency capabilities. Furthermore, during the nine months ended September 30, 2005 the restriction on the cash held in reserve by our merchant banker was lifted and made available to us.

Net cash provided by financing activities was approximately $1,715,000 for the nine months ended September 30, 2004, and net cash used by financing activities was approximately $31,000 for the nine months ended September 30, 2005. The net cash provided by financing activities for the nine months ended September 30, 2004 reflects final settlement on our accounts receivable line of credit, payment made on long term note payables, stock offering costs associated with the Barron Partners, LP equity financing and the proceeds received from convertible debentures and the issuance of stock for Barron Partners. Cash used by financing activities for the nine months ended September 30, 2005 reflects payments made on long-term note payables.

On July 19, 2004, we completed an equity financing in the amount of $1,750,000 through a private placement with Barron Partners, LP. Under the terms of the agreement, Barron purchased 21,875,000 restricted shares of common stock at a price of $0.08 per share. In addition, according to the terms of the agreement, Barron received two warrants to purchase common stock. The first warrant entitles Barron to purchase up to 10,937,500 shares of common stock at a price of $0.18 per share and the second warrant entitles Barron to purchase up to 10,937,500 additional shares of common stock at a price of $0.60 per share; each warrant is subject to standard adjustment provisions. These warrants have been accounted for as a liability according to EITF 00-19. In accordance with accounting mandate, the derivative liability associated with these warrants has been and shall continue until our registration statement on Form SB-2 originally filed on November 22, 2004 is declared effective to be adjusted to fair value at each balance sheet date and is accordingly reassessed at each such time to determine whether the warrants should be classified (or reclassified, as appropriate) as a liability or as equity The fair value of each warrant was initially assessed at $2,187,500 ($4,375,000 total) using the Black-Scholes valuation method. At September 30, 2004 and September 30, 2005, the fair value of the derivative liability was approximately $3,063,000 and approximately $2,844,000, respectively, and a fair value adjustment of approximately $1,385,000 and approximately $875,000, respectively, has been included in other expenses for the nine months then ended.

As part of the July 19, 2004 financing transaction with Barron Partners, LP, we also entered into a certain Registration Rights Agreement pursuant to which we became committed to registering all of the shares issued as part of such transaction, including those issuable under each of two warrants. On November 22, 2004 we filed a registration statement on Form SB-2 covering the shares issued to Barron Partners, as well as the shares underlying the warrants issued to Barron Partners. In accordance with the terms of the Registration Rights Agreement, as amended, we had another 150 days, until April 22, 2005, to cause such registration statement to be declared effective by the SEC, with any delays in meeting this obligation resulting in our being liable to Barron Partners in an amount equal to $630,000 per year, pro-rated for the duration of any such delay, which amounts to $1,726 per day.

As of September 30, 2005 we have accrued $278,000 (161 days at $1,726 per day) in penalties under the terms of the Registration Rights Agreement, inclusive of an adjustment made pursuant to a tentative verbal agreement reached with Barron Partners in April 2005, wherein, in relation to the associated accruing penalties, we agreed to pay Barron Partners an amount in cash equal to $100,000 to toll the accrual of further penalties until June 21, 2005. Although this amount has been paid in full, in two equal installments of $50,000 on each of April 22, 2005 and July 8, 2005, penalties in the amount of $1,726 per day continue to accrue from June 21, 2005 until the registration statement is declared effective, at which time a negotiated reduction of such total amount is expected to be reached, the extent of which is as yet unknown, and terms of payment of which are expected to be agreed to so as to allow us to reasonably meet our ongoing operating needs. Although there can be no assurance, management is hopeful that we will cause such registration statement to be declared effective in the near future. The amount paid by us to date to satisfy this obligation has, and any continued delays in our ability to cause the registration statement to be declared effective coupled with additional amounts which we are and may be required to pay, will have a material adverse effect on our business, our financial condition, including liquidity and profitability, and our results of operations, including a corresponding reduction in our net income and the likelihood of a net loss for the year. See Exhibits 10.10, 10.11, 10.12, and 10.13.

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Contractual Liabilities

We lease office space/warehouse facilities in Omaha, Nebraska under an operating lease with a third-party with terms extending through 2007. We are responsible for all taxes, insurance and utility expenses associated with this lease. There is no lease renewal option contained in the lease.

We lease office space in Naperville, Illinois under an operating lease with a third-party with terms extending through March 2006. We are responsible for all insurance expenses associated with this lease.

At September 30, 2005, the future minimum rental payments required under these leases are as follows:

2005	$ 20,333
2006	69,451
2007	27,288
Total future minimum rental payments	$ 117,072

We lease telephone equipment under a capital lease expiring in November 2009. The asset and liability under the capital lease are recorded at the present value of the minimum lease payments. The asset is depreciated over a 5 year life. Minimum future lease payments under capital leases as of September 30, 2005 for each of the next five years and in the aggregate are:

2005	$ 3,432
2006	13,726
2007	13,726
2008	13,726
2009	12,582
Total minimum lease payments	57,192
Less: Amount representing interest	12,086
Total obligations under capital lease	45,106
Less: Current installments of obligations under capital lease	8,922
Long-term obligation under capital lease	$ 36,184

The Potential Impact of Known Facts, Commitments, Events and Uncertainties on Future Operating Results or Future Liquidity Requirements

New Accounting Pronouncements

In the past, we have applied Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations in accounting as allowed by SFAS No 123, *Accounting for Stock Based Compensation*, for various forms of share-based awards including incentive and nonqualified stock options and stock appreciation rights attached to stock options; and therefore, no compensation cost had been recognized. However, in December 2004, the FASB issued SFAS No 123 (R), *Share-Based Payment*, which replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123 (R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost will be measured based on the fair value on the grant date of the equity or liability instruments issued. Compensation cost will be recognized over the period that the service is provided for that award. This new standard will be effective for the company the first quarter of fiscal 2006. We did not grant any form of share-based awards during the nine months ended September 30, 2005.

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ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

Our CEO and CFO have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the fiscal quarter covered by this report on Form 10-QSB. Based on this evaluation, our CEO and CFO have concluded that these disclosure controls and procedures are effective and designed to ensure that the information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the requisite time periods.

(b) Changes In Internal Controls Over Financial Reporting.

No changes in our disclosure controls and procedures, internal controls over financial reporting or other factors have occurred during the fiscal quarter covered by this report that would materially affect or be reasonably likely to materially affect our disclosure controls and procedures or internal controls over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

As of the date of this report, there were no pending material legal proceedings to which we were a party and we were not aware that any were contemplated. There can be no assurance, however, that we will not be made a party to litigation in the future. Moreover, there can be no assurance that our insurance coverage will prove adequate to cover all liabilities arising out of any claims that may be initiated against us in the future. Any finding of liability imposed against us coupled with a lack of corresponding insurance coverage is likely to have an adverse effect on our business, financial condition, and operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Subsequent to December 31, 2004, the company restored a stale check that was issued to Business Investor Services, Inc. as payment in full of a note payable. This resulted in the conversion of the note payable into 466,666 shares of common stock. The conversion of such securities was effected without registration under the Securities Act of 1933, as amended, based on their being exempted securities under Section 3(a)(9) thereof. There were no underwriters or placement agents involved in this issuance and no commissions were paid.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

There were no reportable events under this Item 3 during the quarterly period ended September 30, 2005.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

There were no reportable events under this Item 4 during the quarterly period ended September 30, 2005.

ITEM 5. OTHER INFORMATION.

The Annual Meeting of the Stockholders of Findex.com, Inc. will be held on May 19, 2006. Stockholders of record who wish to submit a proposal at the 2006 Annual Meeting must provide written notice to the Secretary of the company in accordance with Article IX of our Articles of Incorporation. Under our Articles of Incorporation, such notice must be received by the Secretary no earlier than March 21, 2006, and no later than April 20, 2006.

There were no material changes to the procedures by which security holders may recommend nominees to our board of directors.

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ITEM 6. EXHIBITS.

No.	Description of Exhibit
2.1	Share Exchange Agreement between Findex.com, Inc. and the stockholders of Reagan Holdings, Inc. dated March 7, 2000, incorporated by reference to Exhibit 2.1 on Form 8-K filed March 15, 2000.
3(i)(1)	Articles of Incorporation of Findex.com, Inc., incorporated by reference to Exhibit 3.1 on Form 8-K filed March 15, 2000.
3(i)(2)	Amendment to Articles of Incorporation of Findex.com, Inc. dated November 12, 2004 incorporated by reference to Exhibit 3.1(ii) on Form 10-QSB filed November 12, 2004.
3(ii)	By-Laws of Findex.com, Inc., incorporated by reference to Exhibit 3.3 on Form 8-K filed March 15, 2000.
10.1	Stock Incentive Plan of Findex.com, Inc. dated May 7, 1999, incorporated by reference to Exhibit 10.1 on Form 10-KSB/A filed May 13, 2004.
10.2	Share Exchange Agreement between Findex.com, Inc. and the stockholders of Reagan Holdings Inc., dated March 7, 2000, incorporated by reference to Exhibit 2.1 on Form 8-K filed March 15, 2000.
10.3	License Agreement between Findex.com, Inc. and Parsons Technology, Inc. dated June 30, 1999, incorporated by reference to Exhibit 10.3 on Form 10-KSB/A filed May 13, 2004.
10.4	Employment Agreement between Findex.com, Inc. and Steven Malone dated July 25, 2003, incorporated by reference to Exhibit 10.4 on Form 10-KSB/A filed May 13, 2004.
10.5	Employment Agreement between Findex.com, Inc. and Kirk Rowland dated July 25, 2003, incorporated by reference to Exhibit 10.5 on Form 10-KSB/A filed May 13, 2004.
10.6	Employment Agreement between Findex.com, Inc. and William Terrill dated June 7, 2002, incorporated by reference to Exhibit 10.6 on Form 10-KSB/A filed May 13, 2004.
10.7	Restricted Stock Compensation Agreement between Findex.com, Inc. and John A. Kuehne dated July 25, 2003, incorporated by reference to Exhibit 10.7 on Form 10-KSB/A filed May 13, 2004.
10.8	Restricted Stock Compensation Agreement between Findex.com, Inc. and Henry M. Washington dated July 25, 2003, incorporated by reference to Exhibit 10.8 on Form 10-KSB/A filed May 13, 2004.
10.9	Restricted Stock Compensation Agreement between Findex.com, Inc. and William Terrill dated July 25, 2003, incorporated by reference to Exhibit 10.9 on Form 10-KSB/A filed May 13, 2004.

10.10 Stock Purchase Agreement, including the form of warrant agreement, between Findex.com, Inc. and Barron Partners, LP dated July 19, 2004, incorporated by reference to Exhibit 10.1 on Form 8-K filed July 28, 2004.

10.11 Amendment No. 1 to Barron Partners, LP Stock Purchase Agreement dated September 30, 2004, incorporated by reference to Exhibit 10.3 on Form 8-K filed October 6, 2004.

10.12 Registration Rights Agreement between Findex.com, Inc. and Barron Partners, LP dated July 26, 2004, incorporated by reference to Exhibit 10.2 on Form 8-K filed July 28, 2004.

10.13 Waiver certificate between Findex.com, Inc. and Barron Partners, LP dated September 16, 2004, incorporated by reference to Exhibit 10.4 on Form 8-K filed October 6, 2004.

31.1 Certification of Findex.com, Inc. Chief Executive Officer, Steven Malone, required by Rule 13a-14(a) or Rule 15d-14(a), and dated December 14, 2005. FILED HEREWITH.

31.2 Certification of Findex.com, Inc. Chief Financial Officer, Kirk R. Rowland, required by Rule 13a-14(a) or Rule 15d-14(a), and dated December 14, 2005. FILED HEREWITH.

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32.1 Certification of Findex.com, Inc. Chief Executive Officer, Steven Malone, required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350), and dated December 14, 2005. FILED HEREWITH.

32.2 Certification of Findex.com, Inc. Chief Financial Officer, Kirk R. Rowland, required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350), and dated December 14, 2005. FILED HEREWITH.

Signatures

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

FINDEX.COM, INC.

Date: December 14, 2005	By/s/ Steven Malone Steven Malone President and Chief Executive Officer
Date: December 14, 2005	By/s/ Kirk R. Rowland Kirk R. Rowland, CPA Chief Financial Officer