

Chardan North China Acquisition Corp  
Form S-4/A  
June 28, 2006

As filed with the Securities and Exchange Commission on June 28, 2006

Registration No. 333-132826

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**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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**AMENDMENT NO. 1 TO**  
**REGISTRATION STATEMENT**  
**UNDER THE**  
**SECURITIES ACT OF 1933**  
**ON**  
**FORM S-4**

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**HLS Systems International Ltd.**  
**(Exact name of registrant as specified in its charter)**

**British Virgin Islands**  
(State or other jurisdiction of  
incorporation or organization)

6770  
(Primary Standard  
Industrial  
Classification Code  
Number)

**Not Applicable**  
(I.R.S. Employer  
Identification No.)

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**625 Broadway, Suite 1111**  
**San Diego, California 92101**  
**(619) 795-4627**  
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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**Li Zhang, Chief Executive Officer**  
**625 Broadway, Suite 1111**  
**San Diego, California 92101**  
**(619) 795-4627**  
(Name, address, including zip code, and telephone number, including area code, of agent for service)

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*Copies to:*

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this registration statement becomes effective and all other conditions to the merger contemplated by the Agreement and Plan of Merger described in the enclosed proxy statement/prospectus have been satisfied or waived.

If any of the securities being registered on this form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box: "

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If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act., check the following box and list the Securities Act registration statement Number of the earlier effective registration statement for the same offering. " \_\_\_\_\_

If this form is a post-effective amendment filed pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. " \_\_\_\_\_

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

**Chardan North China Acquisition Corporation**  
**625 Broadway, Suite 1111**  
**San Diego, CA 92101**

To the Stockholders of Chardan North China Acquisition Corporation:

You are cordially invited to attend a special meeting of the stockholders of Chardan North China Acquisition Corporation (“Chardan”), relating to its proposed purchase of all of the issued and outstanding stock of Gifted Time Holdings, Ltd. (“Gifted Time Holdings”), a British Virgin Islands company that owns a controlling interest in operating companies in the People’s Republic of China, known collectively as “HollySys,” and related matters. The meeting will be held at \_\_\_\_ a.m., Pacific Time, on \_\_\_\_\_, 2006, at Chardan’s offices at 625 Broadway, Suite 1111, San Diego, California, 92101.

At this meeting, you will be asked to consider and vote upon the following proposals:

1. to approve a Stock Purchase Agreement, dated as of February 2, 2006, as amended (“Stock Purchase Agreement”) among Chardan and the stockholders of Gifted Time Holdings (the “HollySys Stockholders”) and the transactions contemplated thereby. The Gifted Time Stockholders have already approved the Stock Purchase Agreement;
2. to approve the merger of Chardan with and into a wholly owned subsidiary formed under the laws of the British Virgin Islands, with the name HLS Systems International Ltd. (“HLS”) for the purposes of redomestication of our company to the British Virgin Islands (the “Redomestication Merger”) as part of the acquisition of Gifted Time Holdings; and
3. to approve the Chardan 2006 Equity Plan (“Stock Option Plan”).

If these proposals are approved:

- we will acquire an operating business in China;
- we will change our corporate domicile from the State of Delaware to the British Virgin Islands, which means we will be governed by the laws of the British Virgin Islands;
- we will change our corporate name to “HLS Systems International Ltd.” as a result of the Redomestication Merger;
- the majority of our board of directors and officers will be the designee of the Gifted Time Stockholders;
- the HLS Memorandum of Association and the Articles of Association will become the equivalent of our certificate of incorporation and by-laws, respectively;
- each share of common stock of Chardan will automatically convert into one share of common stock of HLS; and
- each outstanding warrant of Chardan will be assumed by HLS with the same terms, but exercisable for common stock of HLS.

HLS will continue as a reporting company under the Securities Exchange Act of 1934, as amended, and intends to apply to have its units, common stock and warrants traded on the Nasdaq National Market concurrent with the consummation of the Redomestication Merger. HLS will be a foreign private issuer after the Redomestication Merger.

We will not consummate the transactions described under proposal 1 unless the Redomestication Merger in proposal 2 is also approved. Similarly, the Redomestication Merger will not take place if the Stock Purchase Agreement is not approved. The approval of the Stock Option Plan in proposal 3 is not a condition to consummation for the Stock Purchase Agreement and the Redomestication Merger.

Pursuant to the Stock Purchase Agreement, the Gifted Time Stockholders (or the parties to which they have assigned their rights) will be paid an aggregate of \$30,000,000 in cash and will receive an aggregate of 23,500,000 shares of HLS common stock as payment for all the outstanding common stock of Gifted Time Holdings. A variable portion of the cash payment (ranging from \$3,000,000 up to \$7,000,000), will be deferred until Gifted Time Holdings' generates sufficient operating cash flow or HLS receives additional financing. The amount of the cash consideration that is deferred will depend on the number of shares that are redeemed by shareholders who vote against approval of the Stock Purchase Agreement.

The initial cash payment will be made with the funds from the trust account with the balance of the trust account to be used by HLS for operating capital.

As additional consideration, the Gifted Time Stockholders (or the parties to which they have assigned their rights) will be issued up to an aggregate of 8,000,000 shares of common stock of HLS (2,000,000 per year on an all-or-none basis) for each of the four fiscal years beginning with fiscal 2007 if, on a consolidated basis, HLS generates after-tax profits (excluding after-tax operating profits from any subsequent acquisitions of securities that have a dilutive effect) of at least the following amounts:

<b>Year ending June 30,</b>	<b>After-Tax Profit</b>
2007	\$ 23,000,000
2008	\$ 32,000,000
2009	\$ 43,000,000
2010	\$ 61,000,000

The affirmative vote of the holders of a majority of the outstanding shares of Chardan common stock is required to approve each of the Stock Purchase Agreement and the Redomestication Merger. The approval of the Stock Purchase Agreement is subject to an additional condition, that no more than 20% of the shares issued in Chardan's initial public offering (the "Public Shares") both vote against the approval of the Stock Purchase Agreement and are redeemed for their pro rata share of the trust fund, as described in the next paragraph. The affirmative vote of holders of a majority of the shares represented and entitled to vote at the meeting is required for approval of the Stock Option Plan.

Each Chardan stockholder who holds shares of common stock issued in Chardan's initial public offering has the right to vote against the stock purchase proposal, and any who vote against it may also demand that Chardan redeem such stockholder's shares for cash equal to a pro rata portion of the funds held in the trust account into which a substantial portion of the net proceeds of Chardan's initial public offering was deposited. These shares will be redeemed only if the Stock Purchase Agreement is consummated. However, if the holders of 1,150,000 or more shares of common stock issued in Chardan's initial public offering both vote against the stock purchase proposal and demand conversion of their shares, then Chardan will not consummate the Stock Purchase Agreement. Chardan's initial stockholders who purchased their shares of common stock prior to its initial public offering and presently own an aggregate of approximately 17.8% of the outstanding shares of Chardan common stock, have agreed to vote all of their shares on the Stock Purchase Agreement and Redomestication Merger proposals as the majority of the Public Shares are voted. Chardan's initial stockholders do not have the right to redeem their stock.

Immediately after consummation of the Stock Purchase Agreement, if no holder of Public Shares demands that Chardan convert these shares into a pro rata portion of the trust account, Chardan stockholders will own approximately 23% of HLS's issued and outstanding shares of common stock. If one or more holders of the Public Shares vote against the stock purchase proposal and demand that Chardan convert their shares into a pro rata portion of the trust account, then Chardan's stockholders will own less than approximately 23% of HLS's issued and outstanding shares of common stock. If HLS hits its after-tax profits for each of the fiscal years ending June 30, 2007 through 2010, an additional 8,000,000 shares will be issued to the Gifted Time Stockholders, which assuming there are no other issuances of stock or exercise of outstanding warrants, would reduce the percentage of HLS held by Chardan's current shareholders to approximately 18%.

Chardan's shares of common stock, warrants and units currently are listed on the Over-the-Counter Bulletin Board under the symbols CNCA, CNCAW and CNCAU, respectively. Chardan intends to apply for listing on the Nasdaq National Market effective on the consummation of the Redomestication Merger under the proposed symbols HLSS, HLSSW and HLSSU. If the securities are not listed on Nasdaq, they will continue to trade on the OTCBB.

After careful consideration of the terms and conditions of the proposed Stock Purchase Agreement, the Redomestication Merger and the Stock Option Plan, the board of directors of Chardan has determined that the Stock Purchase Agreement and the transactions contemplated thereby, the Redomestication Merger and the Stock Option Plan are fair to and in the best interests of Chardan and its stockholders. The board of directors of Chardan did not obtain a fairness opinion on which to base this assessment. The board of directors of Chardan unanimously recommends that you vote or give instruction to vote "FOR" the approval of the Stock Purchase Agreement, the Redomestication Merger and the Stock Option Plan.

Enclosed is a notice of special meeting and proxy statement containing detailed information concerning the Stock Purchase Agreement and the transactions contemplated thereby, the Redomestication Merger and the Stock Option Plan. Whether or not you plan to attend the special meeting, we urge you to read this material carefully.

**Your vote is important. Whether you plan to attend the special meeting or not, please indicate your votes, sign, date and return the enclosed proxy card as soon as possible in the envelope provided.**

I look forward to seeing you at the meeting.

Sincerely,

Richard D. Propper, MD  
Chairman of the Board

**Chardan North China Acquisition Corporation**  
**625 Broadway, Suite 1111**  
**San Diego, CA 92101**

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS**  
**TO BE HELD ON \_\_\_\_\_, 2006**

TO ALL THE STOCKHOLDERS OF CHARDAN NORTH CHINA ACQUISITION CORPORATION

NOTICE IS HEREBY GIVEN that a special meeting of stockholders, including any adjournments or postponements thereof, of Chardan North China Acquisition Corporation (“Chardan”), a Delaware corporation, will be held \_\_\_\_\_ a.m. Pacific time, on \_\_\_\_\_, 2006, at Chardan’s offices at 625 Broadway, Suite 1111, San Diego, California, 92101 for the following purposes:

- To consider and vote upon a proposal to adopt the Stock Purchase Agreement, dated as of February 2, 2006, as amended, among Chardan, and the stockholders of a holding company known as Gifted Time Holdings, Ltd. (“Gifted Time Holdings”), a British Virgin Islands company that owns or controls operating companies in the People’s Republic of China collectively known as “HollySys”, and the transactions contemplated thereby;
- To consider and vote upon the merger of Chardan into its wholly owned subsidiary HLS Systems International Ltd. (“HLS”), formed under the laws of the British Virgin Islands, for the purposes of reincorporation and redomestication of Chardan to the British Virgin Islands (the “Redomestication Merger”); and
- To consider and vote upon a proposal to adopt the Chardan 2006 Equity Plan.

The board of directors has fixed the close of business on \_\_\_\_\_, 2006 as the record date for which Chardan stockholders are entitled to receive notice of, and to vote at, the Chardan special meeting and any adjournments thereof. Only the holders of record of Chardan common stock on that date are entitled to have their votes counted at the Chardan special meeting and any adjournments or postponements of that meeting.

Chardan will not transact any other business at the special meeting, except for business properly brought before the special meeting (or any adjournment or postponement of the meeting) by Chardan’s board of directors.

Your vote is important. Please indicate your votes on, sign, date and return your proxy card as soon as possible to make sure that your shares are represented at the special meeting. If you are a stockholder of record of Chardan common stock, you may also cast your vote in person at the special meeting. If your shares are held in an account at a brokerage firm or bank, you must instruct your broker or bank on how to vote your shares. If you do not vote or do not instruct your broker or bank how to vote, it will have the same effect as voting against the Stock Purchase Agreement and the Redomestication Merger.

**The board of directors of Chardan unanimously recommends that you vote “FOR” the approval of the Stock Purchase Agreement, the Redomestication Merger and the stock option plan.**

By Order of the Board of Directors,  
Richard D. Propper, MD  
Chairman of the Board

\_\_\_\_\_, 2006



**PROXY STATEMENT FOR SPECIAL MEETING OF STOCKHOLDERS OF  
CHARDAN NORTH CHINA ACQUISITION CORPORATION**

**PROSPECTUS FOR UP TO 6,000,000 UNITS, 19,250,000 SHARES OF COMMON STOCK, AND  
12,000,000 WARRANTS OF HLS AND ONE REPRESENTATIVE UNIT PURCHASE OPTION**

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The board of directors of Chardan North China Acquisition Corporation (“Chardan”) and its wholly-owned subsidiary, HLS Systems International Ltd. (“HLS”) have unanimously approved the acquisition of the shares of Gifted Time Holdings, Ltd., a holding company (“Gifted Time Holdings”) that owns or controls operating companies (known as “HollySys”) in the People’s Republic of China, pursuant to a Stock Purchase Agreement whereby Chardan will purchase all of the outstanding securities of Gifted Time Holdings held by the stockholders (the “Gifted Time Stockholders”). The board of directors of Chardan also has unanimously approved the simultaneous reincorporation of Chardan from the State of Delaware to the British Virgin Islands, through a Redomestication Merger with HLS.

In the Redomestication Merger, HLS will issue its securities in exchange for the outstanding securities of Chardan. This prospectus covers an aggregate of 6,000,000 units, 19,250,000 shares of common stock, 12,000,000 warrants and one representative unit purchase option. The common stock and warrants issuable upon exercise of the aforementioned securities are included in the aggregate amounts stated above. HLS will issue its securities on the same terms as the equivalent securities had been issued by Chardan.

Chardan was organized to serve as a vehicle for the acquisition of an operating business that has its primary operating facilities based in the Peoples Republic of China in any city or province north of the Yangtze River. Gifted Time Holdings, through its Chinese operating companies, is a leader in the automation and controls industry in China.

Chardan’s common stock, warrants and units are currently listed on the Over-the-Counter Bulletin Board under the symbols CNCA, CNCAW and CNCAU, respectively. HLS intends to apply to have its securities listed on the Nasdaq National Market effective at the time of the Redomestication Merger. The proposed symbols are HLSS, HLSSW and HLSSU.

This proxy statement/prospectus provides you with detailed information about the acquisition of Gifted Time Holdings and Redomestication Merger and the special meeting of stockholders. We encourage you to read this entire document and the documents incorporated by reference carefully. **YOU SHOULD ALSO CAREFULLY CONSIDER THE RISK FACTORS BEGINNING ON PAGE 37.**

The acquisition of Gifted Time Holdings and Redomestication Merger will be completed upon approval of at least a majority of the shares of common stock outstanding present in person or by proxy and entitled to vote at the special meeting on \_\_\_\_\_, 2006.

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROXY STATEMENT/PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

**THIS PROXY STATEMENT/PROSPECTUS IS DATED \_\_\_\_\_, 2006, AND IS FIRST BEING MAILED TO CHARDAN STOCKHOLDERS ON OR ABOUT \_\_\_\_\_, 2006.**



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**This proxy statement/prospectus incorporates important business and financial information about Chardan, Gifted Time Holdings and the HollySys Operating Companies that is not included in or delivered with the document. This information is available without charge to security holders upon written or oral request. The request should be sent to:**

**Dr. Richard Propper  
c/o Chardan North China Acquisition Corporation  
625 Broadway, Suite 1111  
San Diego, California 92101  
(619) 795-4627**

To obtain timely delivery of requested materials, security holders must request the information no later than five business days before the date they submit their proxies or attend the special meeting. The latest date to request the information to be received timely is \_\_\_\_\_, 2006.

*The financial statements of Gifted Time Holdings are prepared using Renminbi, the currency of the Peoples Republic of China (“PRC”). For convenience, the Renminbi amounts have been converted throughout the text of the proxy statement/prospectus into United States dollars. Until recently, the Renminbi was a controlled currency, and the exchange rate maintained by the PRC was approximately 8.11 Renminbi to one United States dollar. The Chinese government has recently altered its policy toward the rate of exchange of the Renminbi versus the US dollar. Changing from a previously fixed rate policy regarding the dollar, the Renminbi has recently been permitted to float within a fixed range against a basket of currencies, including the US dollar, Japanese Yen and European Euro, which has resulted in the Renminbi being allowed to appreciate 2% +/- 0.3% vs. the dollar. Since the company’s business is presently 100 percent domestic within PRC, this change will have no effect on the company’s business, but may result in a concomitant increase in its after-tax earnings when stated in dollar terms. In the future, the company’s earnings stated in US dollars will fluctuate in accordance with the change in exchange rate.*

*Under the law of the British Virgin Islands, HLS is authorized to issue “ordinary shares” and holders of ordinary shares are “members.” References to ordinary shares and members have been translated to common stock and stockholders, which are terms more familiar to United States persons, whom Chardan believes are the majority of its stockholders.*

## QUESTIONS AND ANSWERS ABOUT THE MEETING

- Q. Why is Chardan proposing the stock purchase?
- A. Chardan was organized to effect a business combination with an operating business that has its primary operating facilities located in the People's Republic of China in any city or province north of the Yangtze River. The operating companies of Gifted Time Holdings, after the consummation of the stock purchase will be Beijing HollySys Co., Ltd., Hangzhou HollySys Automation Co., Ltd., and Beijing HollySys Haotong Science & Technology Development Co., Ltd. (these three companies are referred to as the "HollySys Operating Companies"). Together they are one of the leading automation and control systems companies in China. The HollySys Operating Companies have, collectively, demonstrated significant growth since commencing operations in 1996. Chardan believes that the HollySys Operating Companies are in a position to expand their business through the development of additional products and the expansion of their customer base, including entry into the international market. As a result, Chardan believes that a business combination with Gifted Time Holdings will provide Chardan stockholders with an opportunity to participate in a combined company with significant growth potential.
- Q. Why is Chardan proposing the Redomestication Merger?
- A. Chardan is proposing the reincorporation of itself into a company formed under the laws of the British Virgin Islands to align its income tax liabilities with the location of its activities to reduce the overall impact of corporate income tax on the surviving company and its stockholders. Because the future operations will be almost exclusively outside the United States, the Redomestication Merger is intended to reduce or entirely eliminate the income tax liability of the company in the United States and permit greater flexibility in structuring acquisitions or creating subsidiaries in China and other countries as the business of Gifted Time Holdings expands as well as with regard to declaring dividends, should the company wish to do so in the future. By becoming a non-United States company, Chardan believes that the successor company will only be taxed on its operations by the jurisdiction in which they are located and undertaken, and will not be subject to additional income taxes merely by virtue of the location of its place of incorporation.
- Q. Why is Chardan proposing the stock option plan?
- A. Chardan is proposing the stock option plan to enable the company to attract, retain and reward its directors, officers, employees and consultants using equity-based incentives.
- Q. What is being voted on?
- A. There are three proposals that you are being asked to vote on. The first proposal is to adopt the Stock Purchase Agreement, dated February 2, 2006, as amended, and the transactions contemplated thereby. We refer to this proposal as the stock purchase proposal.
- The second proposal is to approve the merger of Chardan with and into HLS for purposes of redomestication to the British Virgin Islands. We refer to this proposal as the Redomestication Merger proposal.

The third proposal is to adopt Chardan's 2006 Equity Plan. We refer to this proposal as the stock option plan proposal.

- Q. What vote is required in order to adopt the stock purchase proposal?
- A. The approval of the stock purchase will require the affirmative vote of a majority of the outstanding shares of Chardan's common stock. If the holders of 1,150,000 or more shares of common stock issued in Chardan's initial public offering vote against the stock purchase and demand that Chardan convert their shares into a pro rata portion of the trust account as of the record date, then the stock purchase will not be consummated. No vote of the holders of Chardan's warrants is necessary to adopt the stock purchase proposal or other proposals, and Chardan is not asking the warrant holders to vote on the stock purchase proposal or the other proposals. Chardan will not consummate the transaction described in the stock purchase proposal unless the Redomestication Merger is also approved. Similarly, the Redomestication Merger will not be consummated if the stock purchase proposal is not approved. The approval of the stock option plan proposal is not a condition to the consummation of the stock purchase or Redomestication Merger proposals.
- Q. What vote is required in order to adopt the Redomestication Merger?
- The affirmative vote of the holders of a majority of the outstanding shares of Chardan common stock is required to approve the Redomestication Merger proposal.
- Q. What vote is required in order to adopt the stock option plan?
- A. The approval of the stock option plan will require the affirmative vote of a majority of the shares represented and entitled to vote at the meeting. The approval of the stock option plan is not a condition to the approval of the stock purchase or the Redomestication Merger proposals.
- Q. How do the Chardan insiders intend to vote their shares?
- A. All of the insiders who purchased their shares prior to the initial public offering (including the officers and directors of Chardan) have agreed to vote the shares held by them on the stock purchase and Redomestication Merger proposals in accordance with the vote of the majority of the shares of common stock issued in Chardan's initial public offering. They have indicated that they also will vote in favor of the stock option plan proposal.
- Q. What will I receive in the Redomestication Merger?
- A. Chardan security holders will receive an equal number of shares of common stock of HLS in exchange for their Chardan common stock, and HLS will assume the outstanding Chardan warrants, the terms and conditions of which will not change, except that on exercise, they will receive HLS common stock. However, as a result of the issuance of HLS shares in the stock purchase, the ownership interests of Chardan stockholders will be diluted so that they will only own approximately 23% of HLS. If additional shares are issued to the Gifted Time Stockholders as additional consideration, or if the outstanding warrants are exercised, the current Chardan stockholders will experience further dilution in their ownership of the company. We have also agreed to issue up to 8,000,000 additional shares to the Gifted Time Shareholders if HollySys' earnings for fiscal years 2007 through 2010 reach certain targets. Also, there are outstanding warrants to purchase 12,000,000 additional shares of Chardan stock. If some or all of the incentive shares are issued, and if some or all of the warrants are exercised, then the percentage of Chardan that its current shareholders will own will be less than 23%.

Q. How will the Redomestication Merger be accomplished?

A. Chardan will merge into HLS, Chardan's wholly owned subsidiary that is incorporated as a British Virgin Islands company. As a result of the Redomestication Merger, each currently issued outstanding share of common stock of Chardan will automatically convert into a share of common stock of HLS. This procedure will result in your becoming a stockholder in HLS instead of Chardan.

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- Q. Will the Chardan stockholders be taxed as a result of the Redomestication Merger?
- A. Generally for United States federal income tax purposes, stockholders who are United States holders should not recognize any gain or loss as a result of the Redomestication Merger. We urge you to consult your own tax advisors with regard to your particular tax consequences of the Redomestication Merger.
- Q. Will Chardan be taxed on the Redomestication Merger?
- A. Chardan will recognize gain, but not loss, as a result of the Redomestication Merger equal to the difference, if any, between the adjusted tax basis of any Chardan asset and such asset's fair market value at the effective time of the Redomestication Merger.
- Q. How much of the surviving company will existing Chardan stockholders own?
- A. The Gifted Time Stockholders (or the parties to which they have assigned their rights) initially will receive 23,500,000 shares of common stock of HLS, representing 77% of the issued and outstanding shares immediately after the acquisition. After the stock purchase, if no Chardan stockholders demand that Chardan convert their shares into a pro rata portion of the trust account and no Chardan stockholder exercises its appraisal rights, then Chardan's stockholders who own shares immediately prior to the stock purchase will own approximately 23% of the outstanding common stock of HLS. Existing Chardan stockholders could own less than approximately 23% if one or more Chardan stockholders vote against the stock purchase proposal and demand conversion of their shares into a pro rata portion of the trust account or if they exercise appraisal rights. Similarly, existing Chardan stockholders will own less than 23% of HLS, if HLS issues (as additional consideration) the additional shares to the Gifted Time Stockholders (or the parties to which they have assigned their rights) by reason of HLS achieving the after-tax profit targets specified in the Stock Purchase Agreement for one or more of the four fiscal years beginning with fiscal 2007. If HLS issues the additional shares as additional consideration to the HollySys Stockholders, then the HollySys Stockholders will own approximately 82% of the issued and outstanding common stock of HLS, and existing Chardan stockholders will own approximately 18% of the issued outstanding common stock of HLS. The foregoing discussion assumes that none of the outstanding warrants to acquire common stock of Chardan will be exercised. If some or all of the warrants are exercised, then the current Chardan stockholders will be diluted further.
- Q. How much dilution will I experience?
- A. Currently there are 7,000,000 shares of common stock of Chardan outstanding. At least 23,500,000 additional shares will be issued for acquisition of Gifted Time Holdings. Therefore, current shareholders will own approximately 23% of the company, which is a dilution of absolute ownership of 77%. To the extent shares representing additional consideration are issued to the HollySys Stockholders upon achieving one or more of the after-tax profit targets and outstanding warrants are exercised, the current stockholders will experience further dilution of their ownership interest in the company.
- Q. What will the name of the surviving company be after the
- A. The name of the surviving company following completion of the stock purchase and Redomestication Merger will be "HLS Systems International Ltd."

stock purchase?

- Q. Do I have conversion rights?
- A. If you hold shares of common stock issued in Chardan's initial public offering, then you have the right to vote against the stock purchase proposal and demand that Chardan convert these shares into a pro rata portion of the trust account in which a substantial portion of the net proceeds of Chardan's initial public offering are held. We sometimes refer to these rights to vote against the stock purchase and demand conversion of the shares into a pro rata portion of the trust account as conversion rights. Holders of warrants issued by Chardan do not have any conversion rights.

- Q.If I have conversion rights, how do I exercise them?
- A. If you wish to exercise your conversion rights, you must vote against the stock purchase proposal and at the same time demand that Chardan convert your shares into cash. If, notwithstanding your vote, the stock purchase is completed, then you will be entitled to receive a pro rata portion of the trust account, including any interest earned thereon through the record date. You will be entitled to convert each share of common stock that you hold into approximately \$[\_\_\_\_\_]. If you exercise your conversion rights, then you will be exchanging your shares of Chardan common stock for cash and will no longer own these shares. You will be entitled to receive cash for these shares only if you continue to hold these shares through the closing of the stock purchase and then tender your stock certificate. If you do not make a demand to exercise your conversion rights at the time you vote against the stock purchase proposal (or if you do not vote against the stock purchase proposal), you will lose your conversion rights, and that loss cannot be remedied. If the stock purchase is not completed, then your shares cannot be converted to cash until either you vote against a subsequently proposed combination and exercise your conversion rights or unless Chardan fails to achieve a business combination in a timely manner, at which time your shares will be automatically converted to cash.
- Q.What happens to the funds deposited in the trust account after consummation of the stock purchase?
- A. Upon consummation of the stock purchase:
- the stockholders electing to exercise their conversion rights will receive their pro rata portion of the funds in the trust account;
  - up to \$27,000,000 of the funds in the trust account will be paid to the Gifted Time Stockholders as part of the stock purchase consideration; and
  - any balance of the funds in the trust account will be retained by HLS for operating capital subsequent to the closing of the business combination.
- Q.Under the Stock Purchase Agreement, what obligations will be owed to the HollySys Stockholders following the consummation of the stock purchase?
- A. HLS will be obligated to pay the Gifted Time Stockholders the deferred purchase price (at least \$3 million, and possibly as much as \$7 million, depending on the amount of funds remaining in the trust account in the event that any of Chardan's stockholders exercises their conversion rights) and the additional stock consideration based on the after-tax profits of HLS. The deferred cash purchase price will not be payable until HLS receives at least \$60 million in subsequent financing or HLS generates positive after-tax cash flow equal to twice the deferred amount.
- Q.Who will manage the combined company?
- A. The combined company will be managed by the current management of HollySys. Dr. Wang Changli, who is currently the chief executive officer of HollySys, will become the chief executive officer and a director of HLS. Madame Qiao Li, who is currently the Chairman of HollySys, will be a director and chairman of the HLS board of directors. Kerry S. Propper, who is currently the chief financial officer, secretary, and a director of Chardan, will also become a director of HLS. The four additional directors will be Jerry Zhang, Youxian Sun, Lewis Solomon and Leonard Hafetz.
- Q.Do I have dissenter or appraisal rights?
- A. In connection with the Redomestication Merger, the Chardan stockholders have appraisal rights under Delaware corporate law.

- Q. What happens if the stock purchase is not consummated?
- A. If the stock purchase is not consummated, Chardan will continue to search for an operating company to acquire. However, Chardan will be liquidated if it does not consummate a business combination by February 10, 2007, unless a letter of intent, agreement in principle or definitive agreement has been executed by February 10, 2007, in which case, Chardan will be liquidated if it does not consummate such business combination by August 10, 2007. In any liquidation, the funds held in the trust account, plus any interest earned thereon, together with any remaining net assets outside of the trust, will be distributed pro rata to Chardan's common stockholders, excluding the Chardan initial stockholders, each of whom has waived any right to any liquidation distribution.

- Q. When do you expect the stock purchase to be completed? A. Pending receipt of the required stockholder approvals, it is currently anticipated that the stock purchase will be completed promptly following the Chardan special meeting on \_\_\_\_\_, 2006.
- Q. If I am not going to attend the Chardan special meeting in person, should I return my proxy card instead? A. Yes. After carefully reading and considering the information contained in this proxy statement/prospectus, please fill out and sign your proxy card. Then return the enclosed proxy card in the return envelope as soon as possible, so that your shares may be represented at the Chardan special meeting.
- Q. What will happen if I abstain from voting or fail to vote? A. An abstention or failure to vote will have the same effect as a vote against the stock purchase proposal, but will not have the effect of converting your shares into a pro rata portion of the trust account. An abstention or failure to vote will also have the effect of voting against the Redomestication Merger, but will have no effect on the approval of the stock option plan.
- Q. What do I do if I want to change my vote? A. Send a later-dated, signed proxy card to Chardan's secretary prior to the date of the special meeting or attend the special meeting in person and vote. You also may revoke your proxy by sending a notice of revocation to Chardan's secretary at the address of Chardan's corporate headquarters.
- Q. If my shares are held in "street name" by my broker, will my broker vote my shares for me? A. No. Your broker can vote your shares only if you provide instructions on how to vote. You should instruct your broker to vote your shares, following the directions provided by your broker.
- Q. Do I need to turn in my old certificates? A. No. If you hold your securities in Chardan in certificate form, as opposed to holding them through your broker, you do not need to exchange them for certificates issued by HLS. Your current certificates will represent your rights in HLS. You may exchange them by contacting the transfer agent, Continental Stock Transfer & Trust Company, Reorganization Department, and following their requirements for reissuance. If you elect conversion or appraisal, you will need to deliver your old certificate to Chardan.
- Q. Who can help answer my questions? A. If you have questions about the stock purchase, you may write or call Chardan North China Acquisition Corporation, 625 Broadway, Suite 1111, San Diego, CA 92101. The phone number is (619) 795-4627.

### **Enforceability of Civil Liabilities Against Foreign Persons**

Gifted Time Holdings is incorporated under the laws of the British Virgin Islands, and its operating companies are incorporated under the laws of the PRC and operate only in the PRC. Substantially all of the assets of Gifted Times Holdings' subsidiary HollySys and its Chinese operating companies will be located in the PRC, and the majority of its officers and directors and the experts named in this joint proxy/prospectus are outside the United States. Although China and the United States are signatories to the 1965 Hague Convention on the Service Abroad of Judicial and Extra Judicial Documents in Civil and Commercial Matters, service under this treaty is cumbersome and time consuming and may not result in adequate notice, such that any judgment based on service thereunder may be reopened, relitigated and overturned. Therefore, an investor should understand it is not likely that service of process upon the

company or its subsidiaries, its officers and directors, its assets and experts will be obtainable within the United States or for actions originating in the United States.

It will be difficult for investors to enforce outside the United States a judgment against HLS or its Chinese operating companies or its assets obtained in the United States in any actions, including actions predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any State of the United States. In addition, the directors and executive officers and certain of the experts named in this joint proxy/prospectus are resident outside the United States, and all or a substantial portion of the assets of these persons are or may be located outside the United States. Therefore, it may not be possible for investors to effect service of process within the United States upon them, or to enforce against them any judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any state of the United States.

The difficulty of enforcing a judgment of a United States court in the PRC where most of the assets of the company are located and which is the residence of most of the directors and officers of the company, stems from the lack of any official arrangement providing for judicial assistance to the enforcement of judgments of courts of the United States in the PRC. The PRC does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts within the United States. In the absence of such a treaty, judgments of United States courts will not be enforced in the PRC without review of the merits of the claims and the claims brought in the original action in the United States court will have to be re-litigated on their merits.

Likewise, administrative actions brought by regulatory authorities, such as the SEC, and other actions that result in foreign court judgments, could (assuming such actions are not required by PRC law to be arbitrated) only be enforced in the PRC if such judgments or rulings do not violate the basic principles of the law of the PRC or the sovereignty, security and public interest of the society of China, as determined by a People's Court of China that has jurisdiction for recognition and enforcement of judgments.

We have been advised that there is doubt as to the enforceability in the PRC of any actions to enforce judgments of United States or British Virgin Islands courts arising out of or based on the ownership of the securities of HLS, including judgments arising out of or based on the civil liability provisions of United States federal or state securities laws, and as to whether PRC courts would enforce, in original actions, judgments against HLS, its directors and officers and assets in the PRC predicated solely upon the federal securities laws of the United States. An original action may be brought in the PRC against HLS or its subsidiaries or its directors and officers and experts named in this prospectus/proxy statement only if the actions are not required to be arbitrated by PRC law and only if the facts alleged in the complaint give rise to a cause of action under PRC law. In connection with such an original action, a PRC court may award civil liability, including monetary damages.

## SUMMARY

### Summary

This section summarizes material items related to the proposals to be voted on. These items are described in greater detail elsewhere in this proxy statement/prospectus. You should carefully read this proxy statement/prospectus and the other documents to which this proxy statement/prospectus refers you. See “Where You Can Find More Information.”

### The Companies

#### *Chardan*

Chardan is a blank check company organized as a corporation under the laws of the State of Delaware on March 10, 2005. Chardan was formed to effect a business combination with an unidentified operating business that has its primary operating facilities located in the People’s Republic of China in any city or province north of Yangtze River. In August 2005, Chardan successfully consummated an initial public offering of its equity securities from which it derived net proceeds of approximately \$30.9 million. The prices of Chardan’s common stock, warrants to purchase common stock and units (each unit consisting of one share of common stock and two warrants to purchase common stock) are quoted on the Over-the-Counter Bulletin Board under the symbols CNCA for the common stock, CNCAW for the warrants and CNCAU for the units. Approximately \$29.8 million of the net proceeds of the initial public offering was placed in a trust account and will be released to Chardan upon consummation of the stock purchase, subject to the exercise of conversion rights by holders of less than 20% of the Chardan stock issued in the initial public offering. The balance of the net proceeds from the initial public offering of approximately \$1.1 million has been used by, or is available to, Chardan to pay the expenses incurred in its pursuit of a business combination. Through March 31, 2006, Chardan had incurred a total of approximately \$828,625 in expenses. The most significant expenses incurred to date include approximately \$67,000 for consultants to Chardan who have assisted with due diligence reviews of business combination targets, approximately in travel expenses, office expenses of \$30,000 payable to Chardan Capital LLC, and premiums for general and officer and director insurance of approximately \$46,667. Other than its initial public offering and the pursuit of a business combination, Chardan has not engaged in any business to date. If Chardan does not consummate a business combination by February 10, 2007 (or, if a letter of intent, an agreement in principle or a definitive agreement to complete a business combination has been executed but not consummated by February 10, 2007, by August 10, 2007), then, pursuant to its certificate of incorporation, Chardan’s officers must take all actions necessary to dissolve and liquidate Chardan within 60 days.

The mailing address of Chardan’s principal executive office is Chardan North China Acquisition Corporation, 625 Broadway, Suite 1111, San Diego, California 92101, and its telephone number is (619) 795-4627.

#### *Gifted Time Holdings*

##### *Business Operations*

Gifted Time Holdings was formed to act as a holding company to hold the equity interests in HollySys held directly or indirectly by the HollySys Stockholders. HollySys is one of the leading automation and control system companies in China. The three HollySys Operating Companies are Beijing HollySys Co., Ltd., Hangzhou HollySys Automation Co., Ltd. and Beijing HollySys Haotong Science & Technology Development Co., Ltd. (“Haotong”). The three HollySys Operating Companies are organized and exist under the laws of the PRC. The HollySys Operating Companies develop, sell, and service automation and control systems and components in China. The businesses of the HollySys Operating Companies began in 1996.

For the years ended June 30, 2004 and 2005, HollySys generated approximately \$53.1 million and approximately \$79.6 million in revenue, respectively, principally from its sales of automation systems and equipment to Chinese customers in the power generation and heavy industry sectors.

The HollySys Operating Companies introduced their new platform technology in 2004, HOLLiAS. This platform consists of several modules, each of which can deliver a range of functions independently or can be integrated into an enterprise wide automation and control system. The components of the system were designed to enable HollySys to participate effectively in the most actively growing sectors of the Chinese economy, including general industrial activity, nuclear and fossil fuel power generation, rail transportation and emerging Chinese industries, such as pharmaceutical manufacture and food processing. HollySys also anticipates entering international markets, based on what it perceives to be products that are comparable to those of other automation companies but selling at prices that will give it a competitive advantage.

The current management of the HollySys Operating Companies is led by Dr. Wang Changli, who will become the chief executive officer of HLS and will continue to operate the HollySys Operating Companies. Dr. Wang and Madame Qiao Li, the current chairman of HollySys, will become two of the seven-person board of directors of HLS. Kerry Proper, a current director and officer of Chardan.

The mailing address of HollySys' principal executive offices is 19 Jiancaicheng Middle Road, Xisangi, Haidian District, Beijing China 100096, and its telephone number is (86) 10-82922200.

#### *HollySys Reorganization and Ownership*

Gifted Time Holdings itself does not engage in any operations. Gifted Time Holdings was established under the laws of the British Virgin Islands on September 21, 2005. On September 20, 2005, the parties who would become the beneficial owners of Gifted Time Holdings entered into a reorganization agreement to exchange the equity interests which they held in Beijing HollySys and Hangzhou HollySys for equity in Gifted Time Holdings, effective June 30, 2005. On October 12, 2005, Gifted Time Holdings issued one share to Madame Qiao Li as part of the consideration for transferring 30% equity interests in Hangzhou HollySys to OSCAF after reorganization. On December 30, 2005 Gifted Time Holdings issued 49,999 shares to the British Virgin Islands companies designated by the stockholders of Beijing HollySys and Hangzhou HollySys as described below. Subsequently, the stockholders of Gifted Time Holdings amended the reorganization agreement on December 30, 2005 due to the withdrawal of one investor in Beijing HollySys, Shanghai Jinqiaotong Industrial Development Co. Ltd. ("Shanghai Jinqiaotong"), which originally intended to acquire an additional 20% interest in Hangzhou HollySys but was not able to consummate this transaction. Shanghai Jinqiaotong decided not to purchase the additional 20% interest in Hangzhou HollySys because of a change in its investment strategy. Shanghai Jinqiaotong has continued to have its 20% interest in Beijing HollySys be subject to the reorganization agreement. Upon completion of the amended reorganization agreement, Gifted Time Holdings holds 74.11% of the equity interest in Beijing HollySys and 60% of the equity interest in Hangzhou HollySys. Gifted Time Holdings also indirectly own another 29.64% of Hangzhou HollySys by virtue of the fact that Beijing HollySys, of which Gifted Time Holdings owns 74.11%, owns 40% of Hangzhou HollySys.

The stockholders representing 74.11% of the equity interests of Beijing HollySys each formed a separate British Virgin Islands company, and these stockholders consigned their equity interest in Beijing HollySys to their British Virgin Islands companies as set forth in the tables below. Gifted Time Holdings then entered into consignment agreements with these British Virgin Islands companies to obtain the stockholders' 74.11% equity interest in Beijing HollySys. Gifted Time Holdings also entered into share transfer agreements with two foreign investors in Hangzhou HollySys, Team Spirit Industrial Limited ("Team Spirit") and OSCAF International Co. Limited ("OSCAF"), to obtain their equity interests in Hangzhou HollySys. Team Spirit is owned and controlled by Wang Changli, and OSCAF is owned and controlled by Qiao Li. Team Spirit and OSCAF each owned 30% of the total number of outstanding shares of Hangzhou HollySys. Team Spirit and OSCAF exchanged for shares in Gifted Time Holdings their entire ownership interest in Hangzhou HollySys to Gifted Time Holdings pursuant to the stock transfer agreements. As consideration for that transfer, Sure Grow Profits Limited and Faith Best Profits Limited, the BVI companies appointed by Team Spirit and OSCAF, each received 7,966 shares of Gifted Time Holdings' common stock, representing 15.932% each of the total outstanding common stock of Gifted Time Holdings. The stock transfer agreements are valid and enforceable under PRC laws, and all relevant Chinese governmental authorities have approved the stock transfer. Hangzhou HollySys is a limited liability company, and the transfer restrictions applicable to Beijing HollySys do not apply to limited liability companies under PRC law. The tables below identify the current stockholders of Gifted Time Holdings, Beijing HollySys and Hangzhou HollySys, and provides the names of the various British Virgin Islands companies formed by such stockholders for the purpose of holding their stock in those entities.

#### **Gifted Time Holdings Stockholders**

<b>Beneficial Owner</b>	<b>BVI Company</b>	<b>Percentage of ownership of Gifted Time Holdings</b>
Mei Qinglin	Pioneer Sum Investments Limited	5.516%
Wang Changli	Ace Lead Profits Limited	13.083%
Luo An	Plus View Investments Limited	9.084%
Xu Shengheng	Acclaimed Insight Investments Limited	22.066%
Song Xuesong (legal representative of Shanghai Jinqiaotong)	Allied Earn Investments Limited	18.388%
Wang Changli	Sure Grow Profits Limited	15.932%
Qiao Li	Faith Best Profits Limited	15.932%
<b>Total</b>		<b>100%</b>

**Beijing HollySys Stockholders**

Stockholder	Percentage of ownership of Beijing HollySys
Beijing No. 6 Institute Huasheng High-Tech Co., Ltd.*	24.11%
Beijing New Technology Industry Development and Services Center*	1.78%
Shanghai Jinqiaotong Industrial Development Co., Ltd.	20%
Wang Changli	14.23%
Cheng Wusi (holding stock on behalf of Xu Shengheng, who owns 24% of the shares of Beijing HollySys, and Mei Qinglin, who owns 6% of the shares of Beijing HollySys)	30%
Luo An	9.88%
<b>Total</b>	<b>100%</b>

\* not a party to the reorganization agreement; shares will not be acquired by Gifted Time Holdings.

**Hangzhou HollySys Stockholders**

Stockholder	Percentage of ownership of Hangzhou HollySys
Beijing HollySys Co., Ltd.	40%
Gifted Time Holdings, Ltd. (pursuant to stock transfer agreements entered into with Team Spirit and OSCAF)	60%
<b>Total</b>	<b>100%</b>

Beijing HollySys owns 70% of the equity interests in Haotong. Haotong is a privately owned company that focuses on railway signal automated controls. Beijing HollySys first acquired a 40% interest in Haotong on May 15, 2002, and subsequently acquired an additional 30% interest in Haotong on December 13, 2002. Since Beijing HollySys holds 70% of the ownership interests in Haotong, when 74.11% of the equity interest in Beijing HollySys was consigned to Gifted Time Holdings pursuant to the consignment agreements, Gifted Time Holdings acquired a controlling interest in Haotong as well (with control over 51.9% of the equity interests in Haotong).

The diagram below shows the corporate structure of Gifted Time Holdings, Beijing HollySys and Hangzhou HollySys. The following abbreviations are used in the below diagram:

<b>AII</b>	Acclaimed Insight Investments Limited
<b>PSI</b>	Pioneer Sum Investments Limited
<b>ALP</b>	Ace Lead Profits Limited
<b>PVI</b>	Plus View Investments Limited
<b>AEI</b>	Allied Earn Investments Limited
<b>SGP</b>	Sure Grow Profits Limited
<b>FBP</b>	Faith Best Profits Limited
<b>BJ HLS</b>	Beijing HollySys
<b>HZ HLS</b>	Hangzhou HollySys
<b>Huasheng</b>	Beijing No. 6 Institute Huasheng High-Tech Co., Ltd.
<b>NT Center</b>	Beijing New Technology Industry Development and Services Center
<b>Haotong</b>	Beijing HollySys Haotong Science & Technology Development Co., Ltd.
<b>Huake</b>	Beijing Huake Electronics Co., Ltd.
<b>Electric</b>	Beijing HollySys Electric Tech. Co., Ltd.
<b>Hollyinfo</b>	Beijing Hollyinfo Technology Co., Ltd.
<b>Zhonghao</b>	Beijing HollySys Zhonghao Automation Engineering Technology Co., Ltd.
<b>Hengye</b>	Beijing HollySys Hengye Science & Technology Co., Ltd.

Gifted Time Holdings will not hold 25.89% of the equity interests in Beijing HollySys. Beijing Liusuo Huasheng Technology Co. Ltd. (“Huasheng”) holds 24.11% of the equity interests in Beijing HollySys, and Beijing New Technology Industry Development and Services Center (“NT Center”) holds 1.78% of the equity interests in Beijing HollySys. Because Beijing HollySys owns 40% of the equity interests in Hangzhou HollySys, Huasheng has an indirect beneficial ownership of 9.644% of the shares of Hangzhou HollySys and NT Center has an indirect beneficial ownership of 0.712% of the shares of Hangzhou HollySys. Gifted Time Holdings has not sought and does not intend to seek control of these minority interests, although it would consider a purchase if either stockholder desired to sell its interest following the closing of the stock purchase.

The Chinese corporation law was recently amended, effective January 1, 2006, to prohibit directors or corporate officers of a joint stock company (such as Beijing HollySys) from transferring the ownership of more than 25% of the shares they own annually during their incumbency. However, it is permissible for record owners of a Chinese corporation, who are subject to that restriction on transfer of their stock, to consign to another all the equity interests and control of their stock while retaining only title. This includes the consignment of the record owner’s voting, dispositive, dividend, meeting calling, proposal submission and other rights, so that the consignee is for all intents and purposes the functional owner, except for record ownership.

As the deputy chairman of the board and CEO of Beijing HollySys, Dr. Wang Changli consigned his equity interests in Beijing HollySys stock to Gifted Time Holdings through a BVI company. The other stockholders in Beijing HollySys, who had previously entered into voting-together agreements with Dr. Wang, also consigned their equity interests in Beijing HollySys stock to Gifted Time Holdings through their respective BVI companies. The parties to the voting-together agreements are Mr. Cheng Wusi, Dr. Wang Changli, Mr. Luo An, Shanghai Jinqiaotong Industrial Development Co., Ltd., Team Spirit and OSCAF. These parties are the various individuals and companies that collectively own 74.11% of the equity interests in Beijing HollySys and 60% of the equity interests in Hangzhou HollySys. Considering the further growth of Beijing HollySys, all of the parties to the voting-together agreements believed that they needed to vote together for important issues related to Beijing HollySys’ growth, capital raising matters, and important daily operation decisions. The parties believed that the best representative of their interests would be the person with the best skill set, who is the current CEO, Dr. Wang Changli. Dr. Wang received an education in England with a Ph. D degree in automation control, demonstrated his leadership skills with more than seventeen-years working experience in the automation industry, and has a strong network in the Beijing marketplace. Therefore, all of the above parties entered into a voting-together agreement with Dr. Wang.

After the reorganization, which was effective June 30, 2005, Gifted Time Holdings held 60% of the ownership interests in Hangzhou HollySys and 74.11% equity interest in Beijing HollySys, respectively. In addition, Gifted Time Holdings indirectly owns another 29.64% of Hangzhou HollySys by virtue of the fact that Beijing HollySys owns 40% of Hangzhou HollySys. Since the Chinese corporation law has no restriction on transferring ownership of the shares held by directors and corporate officers of a limited liability company, the restriction on the equity interest held by Dr. Wang in Beijing HollySys will expire once Beijing HollySys has been changed from a joint stock company to a limited liability company. HollySys expects that the process of changing from a joint stock company to a limited liability company will be initiated by the stockholders of Beijing HollySys shortly after the closing of this stock purchase transaction. This change may take up to six months to complete, depending on the process of obtaining government registration.

Counsel for the HollySys Stockholders has opined that the consignment agreements are valid and enforceable under the laws of the PRC so as to give Gifted Time Holdings the equity interests and control of 74.11% of the issued and outstanding stock of Beijing HollySys.

### **The Business Combination**

The Stock Purchase Agreement provides for Chardan to form a wholly owned subsidiary under the laws of the British Virgin Islands, under the name "HLS Systems International Limited" ("HLS"). At the time of closing of the Stock Purchase Agreement, Chardan will merge with and into HLS for the purpose of redomestication out of the United States to secure future tax benefits and greater corporate flexibility to structure the business of Gifted Time Holdings within China and effect acquisitions and reorganizations under Chinese law. Simultaneously with the Redomestication Merger, HLS will acquire all of the issued and outstanding stock of Gifted Time Holdings, gaining control of the three HollySys Operating Companies pursuant to existing stock consignment agreements, dated December 30, 2005, and share transfer agreements dated January 12, 2006 between Gifted Time Holdings and the stockholders of the HollySys Operating Companies. Following consummation of the Stock Purchase Agreement and the Redomestication Merger, Gifted Time Holdings will continue as the surviving company and owner of the stated interests in the HollySys Operating Companies. Pursuant to the Redomestication Merger, all of the Chardan common stock held by Chardan's stockholders will be converted into common stock in HLS on a one-to-one basis and the outstanding warrants issued by Chardan will be assumed by HLS.

Under the Stock Purchase Agreement, the Gifted Time Stockholders (or the parties to which they have assigned their rights) will be paid an aggregate of \$30,000,000 in cash and will receive an aggregate of 23,500,000 shares of HLS common stock for all the outstanding common stock of Gifted Time Holdings. Chardan will defer paying a portion of the cash payment (at least \$3 million, and possibly as much as \$7 million, depending on the amount of funds remaining in the trust account in the event that any of Chardan's stockholders exercise their conversion rights). The amount of the cash payment that will be deferred will be determined at closing and will equal the sum of \$3,000,000 plus two-thirds of the difference between the funds in the trust account (following the exercise of any conversion rights by Chardan Stockholders) and \$30,000,000. The deferred portion of the cash purchase price is not payable until HLS generates positive cash flow of at least twice the deferred amount or HLS receives at least \$60 million of additional financing.

As additional consideration, the Gifted Time Stockholders (or the parties to which they have assigned their rights) will be issued an aggregate of 2,000,000 shares of common stock of HLS for each of the next four years if, on a consolidated basis, HLS generates after-tax profits (excluding after-tax operating profits from any subsequent acquisitions of securities that have a dilutive effect) of at least the following amounts:

Year ending June 30,	After-Tax Profit
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2007	\$23,000,000
2008	\$32,000,000
2009	\$43,000,000
2010	\$61,000,000

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Chardan and the Gifted Time Stockholders plan to complete the stock purchase promptly after the Chardan special meeting, provided that:

- Chardan's stockholders have approved the Stock Purchase Agreement and the Redomestication Merger proposals;
- holders of less than 20% of the shares of common stock issued in Chardan's initial public offering vote against the stock purchase proposal and demand conversion of their shares into cash; and
  - the other conditions specified in the Stock Purchase Agreement have been satisfied or waived.

### **The Stock Purchase Agreement**

The Stock Purchase Agreement is included as an annex to this proxy statement/prospectus. Chardan has entered into two amendments to the Stock Purchase Agreement that are also included as an annex to this proxy statement/prospectus and discussed in more detail on page 66. We encourage you to read the Stock Purchase Agreement. It is the legal document that governs the stock purchase and the other transactions contemplated by the Stock Purchase Agreement. It is also described in detail elsewhere in this proxy statement/prospectus.

### **The Chardan Stock Option Plan**

The stock option plan reserves 3,000,000 shares of Chardan common stock for issuance in accordance with the plan's terms. Chardan does not intend to grant any options or other awards under this plan; instead, the plan will be available for use by the Board of Directors of HLS following the Redomestication Merger. The purpose of the stock option plan is to enable Chardan (or HLS following the Redomestication Merger) to offer its employees, officers, directors and consultants whose past, present and/or potential contributions have been, are or will be important to the success of the company, an opportunity to acquire a proprietary interest in Chardan (or HLS). The various types of awards that may be provided under the stock option plan will enable Chardan to respond to changes in compensation practices, tax laws, accounting regulations and the size and diversity of its business. Upon the Redomestication Merger, HLS will assume the plan and it will be administered by the board of directors of HLS using the common stock of HLS instead of Chardan common stock.

The stock option plan is included as an annex to this proxy statement/prospectus. We encourage you to read the stock option plan in its entirety.

### **Management**

After the consummation of the stock purchase and of the Redomestication Merger, the board of directors of the surviving corporation will be Dr. Wang Changli, Madame Qiao Li, Kerry S. Propper, Jerry Zhang, Youxian Sun, Lewis Solomon and Leonard Hafetz.

Each of Madame Qiao Li and Dr. Wang Changli will enter into a three-year employment agreement with Gifted Time Holdings. Madame Qiao will be employed as Chairman, and Dr. Wang will be chief executive officer. Dr. Wang will also enter into an employment agreement with Beijing HollySys.

### **Special Meeting of Chardan's Stockholders**

The special meeting of the stockholders of Chardan will be held at \_\_\_\_ a.m., Pacific time, on \_\_\_\_\_, 2006, at Chardan's offices at 625 Broadway, Suite 1111, San Diego, California, 92101 to approve the stock purchase, the Redomestication Merger and the stock option plan proposals.

**Approval of the Gifted Time Stockholders**

All of the Gifted Time Stockholders have approved the stock purchase proposal and the transactions contemplated thereby by virtue of the execution of the Stock Purchase Agreement.

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### **Voting Power; Record Date**

You will be entitled to vote or direct votes to be cast at the special meeting if you owned shares of Chardan common stock at the close of business on \_\_\_\_\_, 2006, which is the record date for the special meeting. You will have one vote for each share of Chardan common stock you owned at the close of business on the record date. Chardan warrants do not have voting rights. On the record date, there were \_\_\_\_\_ outstanding shares of Chardan common stock.

### **Vote Required to Approve the Proposals**

The approval of the Stock Purchase Agreement proposal will require the affirmative vote of the holders of a majority of the outstanding shares of Chardan common stock on the record date.

The approval of the Redomestication Merger proposal will require the affirmative vote of the holders of a majority of the outstanding shares of Chardan common stock on the record date and the holders of a majority of the shares of Chardan common stock issued in its initial public offering in August 2005.

The approval of the stock option plan proposal will require the affirmative vote of the holders of a majority of the shares represented and entitled to vote at the meeting.

### **Relation of Proposals**

The stock purchase will not be consummated unless the Redomestication Merger proposal is approved, and the Redomestication Merger will not be consummated unless the stock purchase proposal is approved. The approval of the stock option plan is not a condition to consummation of either the stock purchase or the Redomestication Merger proposals.

### **Conversion Rights**

Pursuant to Chardan's Certificate of Incorporation, a holder of shares of Chardan's common stock issued in its initial public offering may, if the stockholder votes against the stock purchase, demand that Chardan convert such shares into cash. This demand must be made in writing at the same time that the stockholder votes against the stock purchase proposal. If so demanded, Chardan will convert each share of common stock into a pro rata portion of the trust account as of the record date. If you exercise your conversion rights, then you will be exchanging your shares of Chardan common stock for cash and will no longer own these shares. You will be entitled to receive cash for these shares only if you continue to hold these shares through the effective time of the stock purchase and then tender your stock certificate to the combined company. If the stock purchase is not completed, then these shares will not be converted into cash at that time.

The stock purchase will not be consummated if the holders of 20% or more of common stock issued in Chardan's initial public offering (1,150,000 shares or more) exercise their conversion rights.

### **Appraisal Rights**

Appraisal rights are available under the Delaware General Corporation Law for the stockholders of Chardan in connection with the Redomestication Merger proposal. The procedure to exercise appraisal rights is described in detail elsewhere in this proxy statement. For a more complete discussion of appraisal rights, see Annex H.

### **Proxies**

Proxies may be solicited by mail, telephone or in person. If you grant a proxy, you may still vote your shares in person if you revoke your proxy at or before the special meeting. The cost of soliciting proxies will be borne by Chardan. Chardan will solicit stockholders by mail through its regular employees, and may request banks and brokers, and other custodians, nominees and fiduciaries, to solicit their customers who have stock of Chardan registered in the names of such persons and will reimburse them for their reasonable, out-of-pocket costs. Chardan may use the services of its officers, directors, and others to solicit proxies, personally or by telephone, without additional compensation.

## **Stock Ownership**

On the record date, directors and executive officers of Chardan and their affiliates (the “Management Shareholders”) beneficially owned and were entitled to vote 1,250,000 shares of Chardan’s common stock, representing approximately 17% of the currently issued and outstanding shares of Chardan common stock. In connection with its initial public offering, Chardan and EarlyBird Capital, Inc. entered into agreements with each of the Management Shareholders, pursuant to which each Management Shareholder agreed to vote his shares of Chardan common stock (other than shares purchased in the open market) on the business combination in accordance with the majority of the votes cast by the holders of shares issued in connection with the initial public offering. All 1,250,000 shares of Chardan common stock held by the Management Shareholders are subject to Stock Escrow Agreements restricting the stockholder’s ability to transfer those shares until August 2, 2008. These shares will be automatically converted into shares of HLS upon consummation of the Redomestication Merger. The HLS shares issuable to the Management Shareholders as a result of the Redomestication Merger will be subject to the terms of the Stock Escrow Agreements to the same extent as the shares of Chardan common stock are subject to the escrow immediately prior to the Redomestication Merger.

## **Chardan ’s Board of Directors’ Recommendation**

After careful consideration, Chardan’s board of directors has determined unanimously that the stock purchase plan proposal, the Redomestication Merger proposal, and the stock option proposal are fair to, and in the best interests of, Chardan and its stockholders. Chardan’s board has unanimously approved and declared advisable the stock purchase proposal, the Redomestication Merger proposal and the stock option plan proposal, and unanimously recommends that you vote or instruct your vote to be cast “FOR” the adoption of the stock purchase proposal, the Redomestication Merger proposal, and the stock option plan proposal. The board of directors did not obtain a fairness opinion.

## **Interests of Chardan Directors and Officers in the Stock Purchase**

When you consider the recommendation of Chardan’s board of directors that you vote in favor of adoption of the stock purchase proposal, you should keep in mind that a number of Chardan’s executives and members of Chardan’s board have interests in the Stock Purchase Agreement that are different from, or in addition to, your interests as a stockholder. These interests include, among other things:

- if the stock purchase is not approved and Chardan fails to consummate an alternative transaction within the time allotted pursuant to its Certificate of Incorporation, Chardan will be required to liquidate. In such event, the shares of common stock held by Chardan’s officers and directors will be worthless because Chardan’s officers, directors and initial stockholders are not entitled to receive any liquidation proceeds. Additionally, any warrants held by such persons will expire worthless in the event of liquidation;
- after the completion of the stock purchase, Mr. Kerry Propper will serve as a member of the board of directors of HLS; and
- the management of HollySys, which after the completion of the stock purchase will be the management of HLS, has agreed in principle to retain Chardan Capital, LLC, an affiliate of Dr. Propper, Chardan’s Chairman, to provide a variety of ongoing services to HollySys. These services will include the following: assistance with compiling and formatting filings required under securities laws (but not including legal advice); working with HLS legal and accounting professionals to assist HLS in achieving and maintaining compliance with the applicable requirements of the Sarbanes-Oxley Act and U.S. accounting standards; establishing and maintaining the capabilities and procedures to manage relations with investors and the financial community effectively; and advising HLS regarding corporate structure and development, including any strategic business opportunities and their potential effects on the value of the company’s stock and overall business prospects. Chardan contemplates that these services will be provided on a month-to-month basis, terminable at will by HLS without penalty, for a monthly fee of \$30,000, plus reimbursement

of expenses incurred in performing the services. There is not yet a written agreement governing the services to be provided, although the parties may formalize the agreement, to include these and other terms, if the stock purchase occurs.

### **Conditions to the Completion of the Stock Purchase**

Each of Chardan's and the Gifted Time Stockholders' obligation to effect the stock purchase is subject to the satisfaction or waiver of specified conditions, including the following:

#### ***Conditions to Chardan's and the Gifted Time Stockholders' obligations***

- Approval by Chardan's stockholders of the stock purchase and Redomestication Merger proposals;
- the absence of any order or injunction preventing consummation of the stock purchase;
- the absence of any suit or proceeding by any governmental entity or any other person challenging the stock purchase or seeking to obtain from the Gifted Time Stockholders or Chardan any damages;
- at Chardan's stockholders' meeting, holders of less than 1,150,000 shares of common stock issued in Chardan's initial public offering, vote against the stock purchase proposal and demand that Chardan convert their shares into a pro rata portion of the trust account; and
- Certain key members of the management team of the HollySys Operating Companies will have entered into employment agreements in form and substance acceptable to Chardan, providing, among other things, for a term of three years at compensation levels in effect prior to the closing of the stock purchase and including intellectual property assignment and non-competition provisions to be in effect for a period of two years following termination of employment.

#### ***Conditions to Chardan's obligations***

- the Gifted Time Stockholders' representations and warranties that are qualified as to materiality must be true and correct in all respects, and those not qualified as to materiality must be true and correct in all material respects, as of the date of completion of the stock purchase, except representations and warranties that address matters as of another date, which must be true and correct as of that other date, and Chardan must have received an officer's certificate from the HollySys Stockholders to that effect;
- the Gifted Time Stockholders must have performed in all material respects all obligations required to be performed by them;
  - Gifted Time Holdings will have acquired ownership or control of the three HollySys Operating Companies;
- the Gifted Time Stockholders must have received all required and unconditional approvals or consents of governmental authorities, and Chardan must have received written confirmation that such approvals and consents have been received;
- Chardan must have received a written opinion, dated as of the closing date, from Guantao Law Firm, counsel to the Gifted Time Stockholders relating to, among other things, the validity and enforceability of the stock consignment agreements;
- there must not have occurred since the date of the Stock Purchase Agreement any HollySys Material Adverse Effect, as defined in the Stock Purchase Agreement; and
- the Proxy Statement/Prospectus Information, as defined in the Stock Purchase Agreement, accurately describes Gifted Time Holdings, the HollySys Operating Companies and the business in which they are engaged, and the

Gifted Time Stockholders, and the Proxy Statement/Prospectus Information does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements in the Proxy Statement/Prospectus Information not misleading.

***Conditions to the Gifted Time Stockholders' obligation***

- Chardan's representation and warranty regarding the compliance of the Stock Purchase Agreement and the agreements contemplated by the Stock Purchase Agreement with the applicable provisions in Chardan's Certificate of Incorporation must be true and correct in all respects, as of the date of completion of the stock purchase;
- Chardan must have performed in all material respects all obligations required to be performed by them under the Stock Purchase Agreement; and
- there must not have occurred since the date of the Stock Purchase Agreement any Chardan Material Adverse Effect, as defined in the Stock Purchase Agreement.

**No Solicitation**

The Stock Purchase Agreement contains detailed provisions prohibiting each of Chardan and the Gifted Time Stockholders from seeking an alternative transaction. These covenants generally prohibit Chardan and the Gifted Time Stockholders, as well as their officers, directors, subsidiaries, employees, agents and representatives, from taking any action to solicit an alternative acquisition proposal. The Stock Purchase Agreement does not, however, prohibit Chardan from considering an unsolicited bona fide written superior proposal from a third party. The approval of the Stock Purchase Agreement by the HollySys Stockholders has already been given, and no proposal from a third party will be effective to revoke or withdraw that approval.

**Termination, Amendment and Waiver**

The Stock Purchase Agreement may be terminated at any time prior to the consummation of the stock purchase, whether before or after receipt of the Chardan stockholder approval, as follows:

- by mutual written consent of Chardan and the Gifted Time Stockholders;
- by either party if the other party amends a schedule and such amendment or supplement reflects a material adverse change in the condition, operations or prospects of its business;
- by either party if the closing has not occurred by June 15, 2006 (unless such terminating party is in breach of any of its material covenants, representations or warranties);
- by either party if the other party has breached any of its covenants or representations and warranties in any material respect and has not cured its breach within ten business days of the notice of an intent to terminate, provided that the terminating party is itself not in breach;
- by the Gifted Time Stockholders, if the board of directors of Chardan (or any committee thereof) shall have failed to recommend or withdraw or modify in a manner adverse to Gifted Time Holdings its approval or recommendation of the Stock Purchase Agreement and any of the transactions contemplated thereby;
- by Chardan if its board of directors shall have determined in good faith, based upon the advice of outside legal counsel, that failure to terminate the Stock Purchase Agreement is reasonably likely to result in the board of directors breaching its fiduciary duties to stockholders by reason of a pending, unsolicited, bona fide written proposal for a superior transaction; or
- by either party if, at the Chardan stockholder meeting, the Stock Purchase Agreement and the Redomestication Merger shall fail to be approved and adopted by the affirmative vote of the holders of Chardan's common stock, or

20% or more of the shares sold in Chardan's initial public offering request conversion of their shares into the pro rata portion of the trust account in accordance with the Chardan Certificate of Incorporation.

The Gifted Time Stockholders have no right to damages from Chardan or HLS and they have no right to any amount held in the trust account. The Gifted Time Stockholders have agreed not to make any claim against Chardan and HLS that would adversely affect the business, operations or prospects of Chardan and HLS or the amount of the funds held in the trust account.

## **Quotation or Listing**

Chardan's outstanding common stock, warrants and units are quoted on the Over-the-Counter Bulletin Board. HLS intends to apply to have the HLS common stock, warrants and units quoted on the Nasdaq National Market at the consummation of the stock purchase. The proposed Nasdaq symbols are HLSS, HLSSW and HLSSU. Seeking the Nasdaq listing is an obligation of Chardan under the Stock Purchase Agreement. If Nasdaq listing is not achieved, management anticipates that the common stock, warrants and units will continue to trade on the OTCBB.

## **Indemnification by Gifted Time Stockholders**

The Gifted Time Stockholders have agreed to indemnify Chardan for breaches of their representations, warranties and covenants.

## **Comparison of Stockholders Rights**

In connection with the consummation of the Stock Purchase Agreement, Chardan has formed a wholly owned subsidiary under the laws of the British Virgin Islands, under the name of HLS Systems International Ltd. Chardan will, if the stock purchase proposal and Redomestication Merger proposal are approved, merge with HLS, effectively changing its jurisdiction of incorporation from Delaware to the British Virgin Islands. Chardan's common stock will be converted into common stock of HLS. The rights of Chardan stockholders will change accordingly. A comparison of the rights of stockholders under Delaware and British Virgin Islands law is included elsewhere in this proxy statement/prospectus.

## **Material United States Federal Income Tax Consequences of the Stock Purchase**

As described below under the heading "Material U.S. Federal Income Tax Considerations of the Redomestication Merger", it is the opinion of counsel to Chardan that the Redomestication Merger will qualify as a reorganization for United States federal income tax purposes. Accordingly, no gain or loss should be recognized by Chardan stockholders as a result of their exchange of Chardan common stock for the common stock of HLS. Nevertheless, as a result of the Redomestication Merger, Chardan will be treated for United States federal income tax purposes as if it sold all of its assets to HLS. As a result, Chardan will recognize gain (but not loss) as a result of the Redomestication Merger equal to the difference, if any, between the adjusted tax basis in Chardan's assets and such asset's fair market value at the effective time of the Redomestication Merger. Chardan will not, however, recognize any gain or loss as a result of the purchase of HollySys stock, pursuant to the Stock Purchase Agreement.

## **Accounting Treatment**

The stock purchase transaction will be accounted for as a recapitalization of Gifted Time Holdings rather than as an acquisition. The financial statements of HLS will combine the historical statements of Gifted Time Holdings with the balance sheet of Chardan from the effective date of the stock purchase transaction.

## **Regulatory Matters**

The stock purchase and the transactions contemplated by the Stock Purchase Agreement are not subject to any federal or state regulatory requirement or approval, including the Hart-Scott-Rodino Antitrust Improvements Act of 1976, or HSR Act, in the United States or British Virgin Islands, except for filings necessary to effectuate the transactions contemplated by the stock purchase and Redomestication Merger proposals with the State of Delaware and the British Virgin Islands. The stock transfer agreements between Gifted Time Holdings and Team Spirit Industrial Ltd. and OSCAF International Co. Ltd. required approval by the applicable Chinese governmental authorities under PRC law. Hangzhou HollySys received approval of the stock transfer agreements from the Commerce Bureau on February 13,

2006. In addition, in accordance with Notice 75, Notice on Issues concerning Foreign Exchange Management in PRC Residents' Financing and Return investments through Overseas Special Intention Company, promulgated by the Chinese State Administration for Foreign Exchange ("SAFE"), the HollySys Stockholders were required to apply for Foreign Exchange Investment Registration before setting up their respective British Virgin Islands companies and acquiring any equity interest in Gifted Time Holdings. The HollySys Stockholders filed all the necessary documents with SAFE in March 2006, and SAFE has accepted the submission. A more detailed discussion of the Notice 75 requirements promulgated by SAFE are in the "Risk Factors" section on page 37. Aside from the requirements and approvals discussed above, the stock purchase and the transactions contemplated by the Stock Purchase Agreement are not subject to any other foreign regulatory requirements or approvals.

**Board Solicitation**

Your proxy is being solicited by the board of directors of Chardan on each of the three proposals being presented to the stockholders at the special meeting.

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**SELECTED HISTORICAL FINANCIAL DATA**

We are providing the following financial information to assist you in your analysis of the financial aspects of the stock purchase. We derived historical information for Gifted Time Holdings Limited, from the audited consolidated financial statements of Gifted Time Holdings, Ltd. as of and for each of the years ended June 30, 2003, 2004 and 2005. The selected historical financial data for the years ended June 30, 2001 and 2002 and for the nine months ended March 31, 2005 and 2006 are unaudited. We prepared the unaudited consolidated financial information on the same basis as the audited consolidated financial statements. The unaudited financial information includes all adjustments, consisting only of normal and recurring adjustments, that Gifted Time Holdings considers necessary for a fair presentation of its financial position and operating results for the periods presented. The consolidated financial statements are prepared and presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. We derived the Chardan historical information from the audited financial statements for the year ended December 31, 2005. The selected financial data information is only a summary and should be read in conjunction with each company's historical consolidated financial statements and related notes contained elsewhere herein. The financial statements contained elsewhere fully represent the financial condition and operations of the companies that will be combined to form HLS, whose shares are being offered in this registration statement. The historical results included below and elsewhere in this proxy statement/prospectus are not indicative of the future performance of Gifted Time Holdings, Chardan or the combined company resulting from the business combination.

**GIFTED TIME HOLDINGS' HISTORICAL FINANCIAL DATA**

<b>Statement of Income Data</b>	<b>Years Ended June 30,</b>				<b>Nine Months Ended March 31,</b>		
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2005</b>	<b>2006</b>
Revenue	\$ 18,148,063	\$ 28,569,576	\$ 35,985,608	\$ 53,074,256	\$ 79,572,832	\$ 56,352,751	\$ 61,263,491
Gross margin	40.26%	30.84%	31.61%	30.40%	33.80%	31.98%	33.91%
Operating income	3,294,500	3,262,957	3,515,563	7,431,631	13,875,018	10,071,766	10,613,869
Subsidy income	-	212,577	634,612	2,782	2,292,880	1,862,607	2,685,735
Net income (1)	1,263,737	1,664,779	2,227,134	4,735,276	13,703,521	10,111,531	10,103,815
Weighted average common shares	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Income per share (1)	25.27	33.30	44.54	94.71	274.07	202.23	202.08
Cash dividends declared per share	17.91	-	-	-	27.46	-	-
			<b>At June 30,</b>			<b>March 31,</b>	
<b>Balance Sheet Data</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	
	\$ 22,585,923	\$ 28,975,207	\$ 35,668,012	\$ 57,507,123	\$ 78,478,569	\$ 88,601,991	

Total current assets						
Total assets	31,113,380	39,429,145	47,202,013	70,006,021	96,064,098	111,357,991
Total current liabilities						
Long-term liability	4,409,810	6,826,062	9,664,871	5,195,370	6,645,321	1,871,094
Minority Interest						
Stockholders' equity	5,412,921	7,095,493	9,325,349	14,662,138	27,002,456	38,146,185

Notes:

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

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**CHARDAN HISTORICAL FINANCIAL INFORMATION**

	<b>For the Period From March 10, 2005 (Inception) to December 31, 2005</b>	<b>For the three months Ended March 31, 2006</b>
Revenue	\$ -	-
Interest income on trust account	\$ 347,871	245,351
Net loss (1)	\$ (101,742)	(112,998)
Net loss per share (1)	\$ (0.03)	(0.02)
Dividends paid per share	\$ -	-
Total assets (including cash deposited in trust account in 2005)	\$ 31,353,114	31,317,822
Common shares subject to possible conversion	\$ 5,964,017	5,964,017
Stockholders' equity	\$ 24,905,084	24,792,086

## Notes:

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

**SELECTED UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION**

The stock purchase transaction will result in those shareholders in Gifted Time Holdings obtaining a majority of the voting interests in Chardan Sub (subsequently named HLS Systems International Ltd.). Generally accepted accounting principles require that the company whose shareholders retain the majority voting interest in a combined business be treated as the acquirer for accounting purposes. Since Chardan does not have any assets with operating substance except cash, the transaction has been accounted for as reorganization and recapitalization of Gifted Time Holdings. The cash of \$30 million to be paid to the shareholders of Gifted Time Holdings will be accounted for as a capital distribution. The stock purchase transaction utilizes the capital structure of Chardan and the assets and liabilities of Gifted Time Holdings are recorded at historical cost. Although Gifted Time Holdings will be deemed to be the acquiring company for accounting and financial reporting purposes, the legal status of Chardan Sub (subsequently named HLS Systems International Ltd.) as the surviving corporation will not change.

We have presented below selected unaudited pro forma combined financial information that reflects the result of the stock purchase transaction and is intended to provide you with a better picture of what our businesses might have looked like had they actually been combined. The combined financial information may have been different had the companies actually been combined. The selected unaudited pro forma combined financial information does not reflect the effect of asset dispositions, if any, or cost savings that may result from the stock purchase. You should not rely on the selected unaudited pro forma combined financial information as being indicative of the historical results that would have occurred had the companies been combined or the future results that may be achieved after the stock purchase. The following selected unaudited pro forma combined financial information has been derived from, and should be read in conjunction with, the unaudited pro forma condensed combined financial statements and related notes thereto included elsewhere in this proxy statement/prospectus.

	<b>Three months ended March 31, 2006</b>		<b>Year ended December 31, 2005</b>	
	<b>Assuming Maximum Approval</b>	<b>Assuming Minimum Approval</b>	<b>Assuming Maximum Approval</b>	<b>Assuming Minimum Approval</b>
Revenue	\$ 11,831,465	\$ 11,831,465	\$ 88,472,077	\$ 88,472,077
Net income	782,581	762,186	14,721,636	14,692,681
Net income per share	0.02	0.02	0.52	0.53
Dividends paid per share	-	-	-	-

**March 31, 2006**

Total assets	\$ 115,300,030	\$ 113,262,204
Long-term debt	1,871,094	1,871,094
Stockholders' equity	39,049,216	32,938,271

### COMPARATIVE PER SHARE INFORMATION

The following table sets forth selected historical per share information of Gifted Time Holdings and Chardan and unaudited pro forma combined per share ownership information of Gifted Time Holdings and Chardan after giving effect to the stock purchase proposal of Gifted Time Holdings, which includes control of the Gifted Time Holdings Operating Companies and the merger between the Chardan and HLS, assuming a maximum level and a minimum level of approval of the stock purchase by Chardan stockholders who exercise their conversion and/or appraisal right. The stock purchase transaction will be accounted for as a recapitalization of Gifted Time Holdings.

You should read this information in conjunction with the selected historical financial information, included elsewhere in this proxy statement/prospectus, and the historical financial statements of HollySys and Chardan and related notes that are included elsewhere in this proxy statement/prospectus. The unaudited HollySys and Chardan pro forma combined per share information is derived from, and should be read in conjunction with, the Unaudited Pro Forma Combined Financial Information and related notes included elsewhere in this proxy statement/prospectus. The historical per share information of Gifted Time Holdings was derived from its audited financial statements as of and for the years ended June 30, 2004 and 2005 and from its unaudited financial statements as of and for the nine months ended March 31, 2006.

The unaudited pro forma combined per share information does not purport to represent what the actual results of operations of HollySys and Chardan would have been had the companies been combined or to project the Gifted Time Holdings and Chardan results of operations that may be achieved after the stock purchase.

<b>Number of shares of common stock assumed to be issued in stock purchase:</b>	<b>Gifted Time</b>	<b>Chardan (2)</b>	<b>Combined Company (2)</b>
Assuming maximum approval	23,500,000	7,000,000	30,500,000
	77.05%	22.95%	100%
Assuming minimum approval	23,500,000	5,850,575	29,350,575
	80.07%	19.93%	100%
Net income (loss) per share - historical on weighted average basis			
Year ended June 30, 2004:	\$ 94.71		
Year ended June 30, 2005:	\$ 274.07		
Year ended December 31, 2005:		(0.03)(1)	
Nine months ended March 31, 2006	\$ 202.08		
Three months ended March 31, 2006		(0.02)	
Net income per share - pro forma on weighted average basis - diluted Year ended December 31, 2005:			
under maximum approval assumption			\$ 0.52
under minimum approval assumption			\$ 0.53
Three months ended March 31, 2006:			
under maximum approval assumption			\$ 0.02
under minimum approval assumption			\$ 0.02
Net assets at book value per share - March 31, 2006			
(3)		\$ 4.24	\$ 1.12(3)
Net assets at book value per share - June 30, 2005	\$ 540.05		

Notes:

(1) Operations of Chardan are for the period from March 10, 2005 (inception) to December 31, 2005.



(2) Historical per share amounts for Chardan were determined based upon the actual weighted average shares outstanding during the periods presented. The combined pro forma per share amounts for Chardan and Gifted Time Holdings were determined based upon the assumed number of shares to be issued under the two different levels of approval at March 31, 2006.

(3) Calculated based on the minimum approval, to record refund of funds (\$5,964,017 plus \$146,928 for related interest) to dissenting stockholders

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### MARKET PRICE INFORMATION

Chardan's common stock, warrants and units are each quoted on the Over-the-Counter Bulletin Board under the symbols CNCA, CNCAW and CNCAU, respectively. Chardan's units commenced public trading on August 5, 2005 and its common stock and warrants commenced public trading on August 31, 2005. The closing price for each share of common stock, warrant and unit of Chardan on February 1, 2006, the last trading day before announcement of the execution of the Stock Purchase Agreement was \$6.78, \$2.82 and \$12.25, respectively.

In connection with the stock purchase, HLS intends to apply for the quotation of the combined company's common stock, warrants and units on the Nasdaq National Market. The proposed symbols are HLSS, HLSSW and HLSSU. Management anticipates that, if Nasdaq approves this listing, it will be concurrent with the consummation of the Redomestication Merger. If the listing on Nasdaq is not finally approved, management expects that the common stock, warrants and units will continue to trade on the OTCBB. Currently there is no trading market for any securities of HLS, and there can be no assurance that a trading market will develop.

The table below sets forth, for the calendar quarters indicated, the high and low closing prices of the Chardan common stock, warrants and units as reported on the Over-the-Counter Bulletin Board. The over-the-counter market quotations reported below reflect inter-dealer prices, without markup, markdown or commissions and may not represent actual transactions.

	Over-the-Counter Bulletin Board							
	Chardan Common Stock		Chardan Warrants		Chardan Units			
	High	Low	High	Low	High	Low		
2005 Third Quarter	\$ 6.00	\$ 5.17	\$ 1.15	\$ 0.70	\$ 7.50	\$ 6.15		
2005 Fourth Quarter	\$ 5.75	\$ 5.15	\$ 1.86	\$ 1.01	\$ 9.30	\$ 7.20		
2006 First Quarter	\$ 12.90	\$ 5.74	\$ 7.38	\$ 1.65	\$ 27.50	\$ 9.10		
2006 Second Quarter (through June 26, 2006)	\$ 12.60	\$ 7.45	\$ 7.45	\$ 2.60	\$ 27.40	\$ 12.50		

#### Holders

As of February 13, 2006, there was one holder of record of the units, six holders of record of the common stock and one holder of record of the warrants. Chardan believes that there are more than 400 beneficial holders of each of the units, common stock and warrants.

It is anticipated that the number of holders of HLS units, common stock and warrants after the Redomestication Merger will be approximately the same as the number of holders of Chardan common stock. Immediately thereafter the number of holders of common stock will be increased by six persons by the issuance of shares in the acquisition of Gifted Time Holdings.

#### Dividends

Chardan has not paid any dividends on its common stock to date and does not intend to pay dividends prior to the completion of a business combination.

The payment of dividends by HLS in the future will be contingent upon revenues and earnings, if any, capital requirements and general financial condition of Gifted Time Holdings subsequent to completion of a business combination. The payment of any dividends subsequent to a business combination will be within the discretion of the then board of directors. It is the present intention of the board of directors to retain all earnings, if any, for use in the

business operations and, accordingly, the board does not anticipate declaring any dividends in the foreseeable future.

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## RISK FACTORS

*You should carefully consider the following risk factors, together with all of the other information included in this proxy statement/prospectus, before you decide whether to vote or instruct your vote to be cast to adopt the stock purchase proposal.*

*If we complete the acquisition of Gifted Time Holdings, HLS will be subject to a number of risks. You should carefully consider the risks we describe below and the other information included in this proxy statement/prospectus before you decide how you want to vote on the stock purchase proposal. Following the closing of the stock purchase, the market price of our common stock could decline due to any of these risks, in which case you could lose all or part of your investment. In assessing these risks, you should also refer to the other information included in this proxy statement/prospectus, including our consolidated financial statements and the accompanying notes. You should pay particular attention to the fact that we would become a holding company with substantial operations in China. As a result, we would be subject to legal and regulatory environments that differ in many respects from those of the U.S. Our business, financial condition or results of operations could be affected materially and adversely by any of the risks discussed below and any others not foreseen. This discussion contains forward-looking statements.*

**Because Chinese law will govern almost all of HollySys material agreements, we may not be able to enforce our legal rights within the PRC or elsewhere, which could result in a significant loss of business, business opportunities, or capital.**

Chinese law will govern some of our material agreements after the share exchange. Our PRC subsidiaries may not be able to enforce their material agreements, and remedies may not be available outside of the PRC. The system of laws and the enforcement of existing laws in the PRC may not be as certain in implementation and interpretation as in the U.S. 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.

Additionally, substantially all of our assets will be located outside of the U.S. and most of our officers and directors will reside outside of the U.S. As a result, it may not be possible for investors in the U.S. to enforce their legal rights, to effect service of process upon our directors or officers or to enforce judgments of U.S. courts predicated upon civil liabilities and criminal penalties of our directors and officers under Federal securities laws. Moreover, we have been advised that the PRC does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the U.S. Further, it is unclear if extradition treaties now in effect between the U.S. and the PRC would permit effective enforcement of criminal penalties of the Federal securities laws.

**We have control of Beijing HollySys only through contractual agreements with shareholders of Beijing HollySys (i.e., the stock consignment agreements), which may not be as effective as direct ownership because of potential violations of the consignment agreements and the uncertain effect of those agreements.**

At the closing of the stock purchase, we will have control of Beijing HollySys only pursuant to stock consignment agreements entered into between stockholders of Beijing HollySys and Gifted Time Holdings. Through these contractual agreements, we enjoy voting control and are entitled to the economic interests associated with the stockholders' equity interest in Beijing HollySys. These contractual agreements may not be as effective in providing us with control over Beijing HollySys as direct ownership because we must rely on the performance of the respective stockholders under the agreements. If those stockholders fail to perform their respective obligations under the agreements, we may have to expend substantial resources to enforce those agreements, and rely on legal remedies under applicable law, which may not be effective.

While we believe that the ownership structure of Gifted Time Holdings and the contractual agreements between the stockholders and Gifted Time Holdings are valid and effective under existing PRC laws, rules and regulations, there are substantial uncertainties regarding the interpretation and application of current or future PRC laws or regulations, including but not limited to the laws and regulations governing the validity and enforcement of these contractual agreements. If we or our PRC operating companies are found to be in violation of existing or future PRC laws or regulations, the relevant regulatory authorities will have broad discretion in dealing with such violations, which would cause significant disruptions to our business operations or render us unable to conduct our business operations and may materially adversely affect our business, financial condition or results of operations.

In the event that the consignment agreements are cancelled sometime in the future, we would lose the control of Beijing HollySys to the extent that legal title to the stock that is the subject of those agreements was not previously transferred to Gifted Time Holdings.

**If U.S. shareholders sought to sue HollySys' officers or directors, it may be difficult to obtain jurisdiction over the parties and access the assets located in the PRC.**

Because most of our officers and directors will reside outside of the U.S., it may be difficult, if not impossible, to acquire jurisdiction over these persons in the event a lawsuit is initiated against us and/or our officers and directors by a shareholder or group of shareholders in the U.S. Also, because our executive officers will likely be residing in the PRC at the time such a suit is initiated, achieving service of process against such persons would be extremely difficult. Furthermore, because the majority of our assets are located in the PRC it would also be extremely difficult to access those assets to satisfy an award entered against us in U.S. court. Moreover, we have been advised that the PRC does not have treaties with the U.S. providing for the reciprocal recognition and enforcement of judgments of courts.

**We may have difficulty establishing adequate management, legal and financial controls in the PRC, which could result in misconduct and difficulty in complying with applicable laws and requirements.**

Most PRC companies historically have been less focused on establishing Western style management and financial reporting concepts and practices, as well as in modern banking, computer and other internal control systems. We may have difficulty in hiring and retaining a sufficient number of qualified internal control employees to work in the PRC. As a result of these factors, we may experience difficulty in establishing management, legal and financial controls, collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet Western standards.

**HollySys may experience trade barriers in its targeted emerging markets and may be subject to tariffs and taxes that will result in significant additional liabilities for HollySys' business and products.**

HollySys may experience barriers to conducting business and trade in its targeted emerging markets in the form of delayed customs clearances, customs duties and tariffs. In addition, it 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 in which HollySys plans to operate may impose onerous and unpredictable duties, tariffs and taxes on its business and products, and there can be no assurance that this will not have an adverse effect on its finances and operations.

**Cessation of or changes to certain government incentives for high technology companies may result in increased tax liabilities.**

The Chinese government and various provincial governments have provided various incentives to high technology companies in order to encourage development of the domestic high technology industry. Such incentives include reduced tax rates and other measures. HollySys is currently enjoying a reduction of income tax rates under the central government and provincial government laws.

Beijing HollySys is registered in a high-tech zone located in Beijing and has been deemed as a high-tech company by the Beijing Commission of Science and Technology. As a result, it is entitled to a preferential enterprise income tax rate of 15%, so long as it continues to operate in the high-tech zone and maintains its high or new technology enterprise status.

Beijing HollySys Haotong (Haotong) is also registered in a high-tech zone located Beijing and has been deemed as a high-tech company by Beijing Commission of Science and Technology. Therefore, Haotong is also entitled to the

favorable income tax rate at 15% so long as it continues to operate in the high-tech zone and maintains its high or new technology enterprise status as well. Under the favorable 15% of corporate income tax rate, Haotong received a 100% exemption of income tax for three years ending December 31, 2003 and a 50% exemption of income tax for three years from January 1, 2004 to December 31, 2006.

Hangzhou HollySys is registered as foreign investment enterprise conducting production functions. Under the provisional regulations, for Hangzhou HollySys, the 30% income tax rate belonging to the central government was reduced to 24%, and the 3% income tax rate belonging to the local government was reduced to 2.4%. Accordingly, the applicable income tax of Hangzhou HollySys was 26.4%. In accordance with the foreign investment enterprise income tax law, Hangzhou HollySys has entitled to receive a 100% exemption of income tax for two years and a 50% exemption of income tax for the next three years beginning the first year Hangzhou HollySys generates a taxable income on a continuing basis. During the fiscal years ended June 30, 2004 and 2005, Hangzhou HollySys was still under 100% exemption status.

As long as Beijing HollySys and Haotong continue to operate in the high-tech zone and maintain their high or new technology enterprise status, they will be entitled to 15% of corporate income tax rate. Any loss or reduction of the favorable tax rates would affect HollySys' operating results.

Normally, domestic-invested enterprises in China are subject to a 33% income tax rate. The Chinese government intends to eliminate differences between the applicable tax rates of domestic and foreign-invested enterprises, but the schedule for the unification of tax rates has not yet been established. If this happens, it may have a material adverse effect on Hangzhou HollySys.

As these tax benefits expire, the effective tax rate will increase significantly, and any increase in HollySys' enterprise income tax in the future could have a material adverse effect on our financial condition and results of operations.

In addition, the local government in Beijing and Hangzhou have provided subsidies from value added tax collections to encourage Beijing HollySys', Haotong's and Hangzhou HollySys' research and development efforts and other subsidies to Beijing HollySys for enterprise development purposes. Early in fiscal 2005 the local government in Beijing provided specified subsidies to offset interest expenses to encourage Beijing HollySys' research and development efforts. The subsidies from value added tax collections will cease at the end of 2010. HollySys may not continue to receive other subsidies from the local government in the future. If governmental subsidies were reduced or eliminated, HollySys' after-tax income would be adversely affected.

**The market price of our shares is subject to price and volume fluctuations, so stockholders may not be able to resell shares at or above the price paid, or at any price.**

The markets for equity securities have been volatile. The price of our common shares may be subject to wide fluctuations in response to variations in operating results, news announcements, trading volume, general market trends both domestically and internationally, currency movements and interest rate fluctuations or sales of common shares by our officers, directors and our principal shareholders, customers, suppliers or other publicly traded companies. Certain events, such as the issuance of common shares upon the exercise of our outstanding stock options, could also materially and adversely affect the prevailing market price of our common shares. Further, the stock markets in general have recently experienced price and volume fluctuations that have affected the market prices of equity securities of many companies and that have been unrelated or disproportionate to the operating performance of such companies. These fluctuations may materially and adversely affect the market price of our common shares and the ability to resell shares at or above the price paid, or at any price.

**In the redomestication transaction, we will become a British Virgin Islands company and, because the rights of shareholders under British Virgin Islands law differ from those under U.S. law, you may have fewer protections as a shareholder.**

Following the Redomestication Merger, our corporate affairs will be governed by our Memorandum and Articles of Association, the Business Companies Act of the British Virgin Islands and the common law of the British Virgin Islands. The rights of shareholders to take action against the directors, actions by minority shareholders and the fiduciary responsibility of the directors under British Virgin Islands law are to a large extent governed by the common law of the British Virgin Islands. The common law of the British Virgin Islands is derived in part from comparatively limited judicial precedent in the British Virgin Islands as well as from English common law, which has persuasive, but not binding, authority on a court in the British Virgin Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under British Virgin Islands law are not as clearly established as they would be under statutes or judicial precedent in some jurisdictions in the United States. In particular, the British Virgin Islands has a less developed body of securities laws as compared to the United States, and some states (such as Delaware) have more fully developed and judicially interpreted bodies of corporate law.

**British Virgin Islands companies may not be able to initiate shareholder derivative actions, thereby depriving shareholders of the ability to protect their interests.**

British Virgin Islands companies may not have standing to initiate a shareholder derivative action in a federal court of the United States. The circumstances in which any such action may be brought, and the procedures and defenses that may be available in respect to any such action, may result in the rights of shareholders of a British Virgin Islands company being more limited than those of shareholders of a company organized in the United States. Accordingly, shareholders may have fewer alternatives available to them if they believe that corporate wrongdoing has occurred. The British Virgin Islands courts are also unlikely to recognize or enforce against us judgments of courts in the United States based on certain liability provisions of U.S. securities law; and to impose liabilities against us, in original actions brought in the British Virgin Islands, based on certain liability provisions of U.S. securities laws that are penal in nature. There is no statutory recognition in the British Virgin Islands of judgments obtained in the United States, although the courts of the British Virgin Islands will generally recognize and enforce the non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits. This means that even if shareholders were to sue us successfully, they may not be able to recover anything to make up for the losses suffered.

**The laws of the British Virgin Islands provide little protection for minority stockholders, so minority stockholders will have little or no recourse if the stockholders are dissatisfied with the conduct of the affairs of HLS.**

Under the law of the British Virgin Islands, there is little statutory law for the protection of minority shareholders. The principal protection under statutory law is that shareholders may bring an action to enforce the constituent documents of the corporation, the Articles and the Memorandum of Association. Shareholders are entitled to have the affairs of the company conducted in accordance with the general law and the articles and memorandum. The company is obliged to hold an annual general meeting and provide for the election of directors. Companies are obligated to appoint an independent auditor and shareholders are entitled to receive the audited financial statements of the company.

There are common law rights for the protection of shareholders that may be invoked, largely dependent on English company law, since the common law of the British Virgin Islands for business companies is limited. Under the general rule pursuant to English company law known as the rule in *Foss v. Harbottle*, a court will generally refuse to interfere with the management of a company at the insistence of a minority of its shareholders who express dissatisfaction with the conduct of the company's affairs by the majority or the board of directors. However, every shareholder is entitled to have the affairs of the company conducted properly according to law and the constituent documents of the corporation. As such, if those who control the company have persistently disregarded the requirements of company law or the provisions of the company's memorandum of association or articles, then the courts will grant relief. Generally, the areas in which the courts will intervene are the following: (i) an act complained of which is outside the scope of the authorized business or is illegal or not capable of ratification by the majority, (ii) acts that constitute fraud on the minority where the wrongdoers control the company, (iii) acts that infringe on the personal rights of the shareholders, such as the right to vote, and (iv) where the company has not complied with provisions requiring approval of a special or extraordinary majority of shareholders, which are more limited than the rights afforded minority stockholders under the laws of many states in the U.S.

**If the PRC does not continue its policy of economic reforms, it could result in an increase in tariffs and trade restrictions on products HollySys produces or sells.**

The PRC government has been reforming its economic system since the late 1970s. The economy of the PRC has historically been a nationalistic, "planned economy," meaning it has functioned and produced according to governmental plans and pre-set targets or quotas.

However, in recent years, the PRC government has implemented measures emphasizing the utilization of market forces for economic reform and the reduction of state ownership in business enterprises. HollySys' business has benefited greatly from that new outlook. Although we believe that the changes adopted by the PRC government have had a positive effect on the economic development of the PRC, additional changes still need to be made. For example, a substantial portion of productive assets in the PRC are still owned by government entities. Additionally, governments continue to play a significant role in regulating industrial development. We cannot predict the timing or extent of any future economic reforms that may be proposed.

A recent positive economic change has been the PRC's entry into the World Trade Organization, the global international organization dealing with the rules of trade between nations. Many observers believe that the PRC's entry will ultimately result in a reduction of tariffs for industrial products, a reduction in trade restrictions and an increase in international trade with China. However, the PRC has not yet fully complied with all of obligations that it must meet prior to being admitted as a full member of the WTO, including fully opening its markets to goods from other countries, currency exchange requirements and other measures designed to ease the current trade imbalance that China has with many of its trading partners. If the scheduled actions to rectify these problems are not completed, trade relations between China and some of its trading partners may be strained. While the majority of HollySys' business

currently is conducted solely within China, this may have a negative impact on China's economy generally, which would adversely affect its business. It could also reduce or eliminate any benefits that HollySys hopes to achieve by expanding our business internationally.

**The Chinese government could change its policies toward, or even nationalize, private enterprise, which could reduce or eliminate the interests held in the HollySys Operating Companies.**

Over the past several years, the Chinese government has pursued economic reform policies, including the encouragement of private economic activities and decentralization of economic regulation. The Chinese government may not continue to pursue these policies or may significantly alter them to HollySys' detriment from time to time without notice. Changes in policies by the Chinese government that result in a change of laws, regulations, their interpretation, or the imposition of high levels of taxation, restrictions on currency conversion or imports and sources of supply could materially and adversely affect HollySys' business and operating results. The nationalization or other expropriation of private enterprises by the Chinese government could result in the total loss of our investment in China.

**The Chinese legal system may have inherent uncertainties that could materially and adversely impact HollySys' ability to enforce its agreements.**

The performance of the agreements and the operations of HollySys' factories are dependent on its relationship with the local government in China. HollySys' operations and prospects would be materially and adversely affected by the failure of the local government to honor its agreements or an adverse change in the laws governing them. In the event of a dispute, enforcement of these agreements could be difficult in China. China tends to issue legislation which is followed by implementing regulations, interpretations and guidelines that can render immediate compliance difficult. Similarly, on occasion, conflicts arise between national legislation and implementation by the provinces that take time to reconcile. These factors can present difficulties in HollySys achieving compliance. Unlike the U.S., China has a civil law system based on written statutes in which judicial decisions have limited precedential value. The Chinese government has enacted laws and regulations to deal with economic matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, its experience in implementing, interpreting and enforcing these laws and regulations is limited, and HollySys ability to enforce commercial claims or to resolve commercial disputes in China is therefore unpredictable. Agencies of the Chinese government may exercise considerable discretion over these matters, and forces and factors unrelated to the legal merits of a particular matter or dispute may influence their determination.

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

Industrial companies operating in China are the principal current source of revenues for HollySys. HollySys' 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 HollySys' 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 and other comparative advantages. 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 HollySys' revenues. The resulting increase in competition for customers might also cause erosion of profit margins that HollySys has been able to achieve historically.

**HollySys may not obtain the required certification to engage in the railway systems market segment, which would prevent HollySys from providing products and services independently in the important railway market.**

At present there are only two Chinese companies that are certified to design and produce traffic control systems for railway transportation. HollySys does not yet have that certification, which is necessary for it to be able to provide complete systems for that purpose independent of other parties. HollySys is in the process of obtaining that certification, and it expects to do so by the end of its current fiscal year (June 30 2006). However, it may not achieve

that certification in a timely manner or at all. Any delay in obtaining that certification would postpone and reduce the anticipated revenues associated with its entry into that sector, and if it fails to obtain the certification it would lose the ability to provide products and services independently in that market. The result would be an unfavorable effect on our overall operating results.

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

While the principal focus of HollySys' business until recently has been to provide distributed control systems to industrial and manufacturing companies, its 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. HollySys may not be successful in entering these new markets and, if it were unable to do so, its revenues and profits would decline, resulting in a decreased value of our stock.

**HollySys does not have long-term purchase commitments from its customers, so its customers are free to choose products from HollySys' competitors, which would result in a loss of revenue and profitability.**

HollySys is engaged in the design, production and installation of automation and process control systems. As a result, its 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 its business, HollySys must be able to replenish the orders in its pipeline on a continuous basis. It is possible that some of its potential customers could choose the products of its competitors. Should they do so, HollySys would suffer a decline in revenues and profitability.

**The success of HollySys' business depends heavily on securing a steady stream of new customers.**

HollySys' 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 HollySys' business to continue to succeed and grow, it needs to secure contracts with new customers on a regular basis. HollySys may not be successful in securing new contracts.

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

One of the competitive advantages that HollySys' business enjoys is the relatively low cost of engineering staff compared to those of its Western and Japan-based competitors. The plentiful supply of affordable engineering talent in China is a key element of HollySys' 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 HollySys' profitability and business prospects, or could even cause a change in its business strategy.

**Many of HollySys' competitors have substantially greater resources than HollySys, allowing the competitors to be able to reduce their prices, which would force HollySys to reduce its prices.**

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

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

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 HollySys designs and builds has accelerated the pace of change in its 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.

The success of HollySys' business depends in great measure on its ability to keep pace with, or even lead, the changes that are occurring. Technological advances, the introduction of new products, new designs and new manufacturing techniques by its competitors could adversely affect its business unless it is able to respond with similar advances. To remain competitive, HollySys 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 HollySys has incurred to date. As a result, it 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.

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

**Products HollySys delivers may contain design or manufacturing defects, which could result in reduced demand for its services and customer claims.**

HollySys manufactures spare parts for maintenance and replacement purposes after completion of integrated solution contracts to its customers' requirements, which can be highly complex and may at times contain design or manufacturing errors or failures. Any defects in the spare parts it manufactures, whether caused by a design, manufacturing or component failure or error, may result in returns, claims, delayed shipments to customers or reduced or cancelled customer orders. If these defects occur, HollySys will incur additional costs, and if they occur in large quantity or frequently, HollySys may sustain additional costs, loss of business reputation and legal liability.

While not insignificant, the risk of failure of HollySys' integrated solutions in the industrial sector normally involves limited potential of liability. For example, if the controls for an industrial production batch process fail to operate properly, HollySys' customer could lose the batch in question. However, the risk of a catastrophic failure is relatively small, based on following facts:

- 1) HollySys adopts advanced technologies, e.g. multi-redundancy, to ensure high safety and reliability of its systems provided to customers by starting the backup system immediately in the event of a problem, and all systems are subject to strict installation testing prior to implementation;
- 2) HollySys has not entered into any contracts with clients that include compensation terms related to system safety failure; therefore, HollySys believes there is no risk related to projects with nuclear power plants or railway stations; historically, HollySys has not encountered any liabilities related to product failures; and
- 3) Nuclear power plant or railway systems have a comprehensive safety protection mechanism, which ensures that the operational continuity of the entire nuclear power plant or rail system would not be affected by any individual system component's malfunction. The nuclear power plant and railway station control systems supplied by HollySys are only a part of whole system, and their failure would not result in a catastrophic, system-wide failure.

HollySys is 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.

HollySys may not be able to obtain adequate insurance coverage to protect it and us against these and other risks associated with its business. The typical practice of the industries which HollySys is involved is for the customers to obtain insurance to protect their own operational risks. Therefore, HollySys currently does 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 HollySys for the damages caused by a failure in one of its systems, and as a result, the failure of any of its products could result in a liability that would seriously impair our financial condition or even force us out of business.

**HollySys expects to rely increasingly on its proprietary products and systems, and if HollySys becomes involved in an intellectual property dispute, it may be forced to spend a significant amount of time and financial resources to resolve such intellectual property dispute, diverting time and resources away from HollySys' business and operations.**

HollySys' business is based on a number of proprietary products and systems, some of which are patented, others of which it protects as trade secrets. HollySys expects that its reliance on these proprietary products and systems will grow, as the functionality of automation systems increases to meet customer demand and as it tries to open new markets for its products. If a third party should infringe on any of HollySys' intellectual property rights, it may need to devote significant time and financial resources to attempt to halt the infringement, and it may not be successful in such a dispute. Similarly, in the event of an infringement claim against HollySys, it may be required to spend a significant amount of time and financial resources to resolve the claim. It may not be successful in defending its position or negotiating an alternative. Any litigation could result in substantial costs and diversion of its management resources and could materially and adversely affect its business and operating results.

**HollySys 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.**

HollySys operates in an industry characterized by increasingly frequent and rapid technological advances, product introductions and new design and manufacturing improvements. As a result, it 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 its design and manufacturing processes and techniques. It 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. HollySys 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 its future operating results. HollySys' future operating results will depend significantly on its ability to provide timely design and manufacturing services for new products that compete favorably with design and manufacturing capabilities of third party suppliers.

**If HollySys is not able to apply new technology in its products or develop new products, it may not be able to stay competitive in a changing industry to meet customers' needs.**

HollySys success depends, in significant part, on its ability to develop products and services that customers will accept. It may not be able to develop successful new products in a timely fashion. Its commitment to customizing products to address particular needs of its customers could burden its resources or delay the delivery or installation of its products. If there is a fundamental change in its industry, some of HollySys' products could become obsolete and it may need to develop new products rapidly.

**HollySys' plans to enter the international automation market may not prove successful, and capital, resources and management's time and attention would have been diverted to such plans for the international market instead of focusing on the domestic Chinese market.**

To date HollySys has conducted nearly all of its business within China. However, it has plans to enter international markets in the near future. While the manner in which HollySys plans to do so will likely not involve large amounts of capital and resources, it will require meaningful amounts of management time and attention. HollySys' products and its 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 its management from these activities may detract from their efforts in the domestic Chinese market, causing the operating results in its principal market to be

adversely affected.

**Expiration of or changes to certain government incentives could result in increased expenses and liabilities (e.g., an increase in income tax liability), which would have a material adverse effect on HollySys' financial condition and operating results.**

The PRC government and various provincial governments have provided various incentives to high technology companies in order to encourage development of the domestic high technology industry. Such incentives include reduced tax rates and other measures. For example, since HollySys is registered in a high technology zone in Beijing and has been designated as a high technology company by the Beijing Commission of Science and Technology, it is entitled to a preferential enterprise income tax rate of 15% so long as it continues to operate in the high tech zone and maintains its high or new technology enterprise status. As these tax benefits expire, the effective tax rate will increase significantly, and any increase in HollySys' enterprise income tax in the future could have a material adverse effect on our financial condition and results of operations.

**HollySys may not be able to retain, recruit and train adequate management and production personnel, and increased competition for qualified personnel in China could result in an increase in wages that HollySys may not be able to offer in order to stay competitive.**

HollySys success is dependent, to a large extent, on its ability to retain the services of its executive management personnel, who have contributed to its growth and expansion. The executive directors play an important role in the operations of HollySys and the development of its new products. Accordingly, the loss of their services, in particular Dr. Wang Changli, without suitable replacement, will have an adverse affect on its operations and future prospects.

In addition, HollySys' continued operations are dependent upon its ability to identify and recruit adequate engineering and production personnel in China. It requires trained graduates of varying levels and experience and a flexible work force of semi-skilled operators. With the current rate of economic growth in China, competition for qualified personnel will be substantial. The favorable employment climate may not continue and the wage rates HollySys must offer to attract qualified personnel may not enable it to remain competitive internationally.

**Because our operations will be international, we will be subject to significant worldwide political, economic, legal and other uncertainties.**

Upon consummation of the proposed transaction, we will be incorporated in the BVI and will have our principal operations in China. Because HollySys manufactures all of its products in China, substantially all of the net book value of our total consolidated fixed assets will be located there. While until now nearly all of HollySys' sales have been within China, it is expanding its efforts to sell them internationally as well. As a result, HollySys expects to have receivables from and goods in transit outside of China in the near future. Protectionist trade legislation in the U.S. or other countries, such as a change in export or import legislation, tariff or duty structures, or other trade policies, could adversely affect HollySys' ability to sell products in these markets, or even to purchase raw materials or equipment from foreign suppliers.

HollySys is also subject to numerous national, state and local governmental regulations, including environmental, labor, waste management, health and safety matters and product specifications. It is subject to laws and regulations governing its relationship with its employees, including: wage and hour requirements, working and safety conditions, citizenship requirements, work permits and travel restrictions. These include local labor laws and regulations, which may require substantial resources for compliance. HollySys is subject to significant government regulation with regard to property ownership and use in connection with its leased facilities in China, import restrictions, currency restrictions and restrictions on the volume of domestic sales and other areas of regulation, all of which impact its profits and operating results.

**Because HollySys plans to increase the amount of international business it conducts and may use currencies other than the Renminbi, which is expected to appreciate against the dollar over time, HollySys may experience a decrease in earnings because of the fluctuation of the Renminbi against the dollar and other currencies.**

The value of the Renminbi, the main currency used in the PRC, fluctuates and is affected by, among other things, changes in the PRC's political and economic conditions. The conversion of Renminbi into foreign currencies such as the dollar has been generally based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. The official exchange rate had remained stable over the past several years. However, the PRC recently adopted a floating rate with respect to the Renminbi, with a 0.3% fluctuation. As a result, the exchange rate of the Renminbi recently rose to 8.11 against the dollar, amounting to a 2% appreciation of the Renminbi. Most of HollySys' business is currently conducted inside of China using the Renminbi. As a result, changes in the exchange rate between it and other currencies should not have a material adverse effect on HollySys' current business. In fact, to the extent that the Renminbi appreciates against the dollar over time, which is widely anticipated, the result will be to increase HollySys'

earnings when stated in dollar terms.

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However, HollySys is planning to increase the amount of business that it conducts internationally, and this floating exchange rate, and any fluctuation in the value of the Renminbi that may result, could have various adverse effects on its business.

**Changes in foreign exchange regulations in the PRC may affect HollySys' ability to pay dividends in foreign currency or conduct other foreign exchange business.**

Renminbi, or RMB, is not presently a freely convertible currency, and the restrictions on currency exchanges may limit our ability to use revenues generated in RMB to fund our business activities outside the PRC or to make dividends or other payments in U.S. dollars. The PRC government strictly regulates conversion of RMB into foreign currencies. Over the years, foreign exchange regulations in the PRC have significantly reduced the government's control over routine foreign exchange transactions under current accounts. In the PRC, the State Administration for Foreign Exchange ("SAFE") regulates the conversion of the RMB into foreign currencies. Currently, Foreign Invested Enterprises are required to apply for "Foreign Exchange Registration Certificates." Hangzhou HollySys is a Foreign Invested Enterprise that has obtained the registration certification, and with such registration certification, which needs to be renewed annually, it is allowed to open foreign currency accounts including "current account" and "capital account." Currently, conversion within the scope of the "current account" (e.g. remittance of foreign currencies for payment of dividends, etc.) can be effected without requiring the approval of SAFE. However, conversion of currency in the "capital account" (e.g. for capital items such as direct investments, loans, securities, etc.) still requires the approval of SAFE. In accordance with the existing foreign exchange regulations in the PRC, Hangzhou HollySys will be able to pay dividends in foreign currencies, without prior approval from the SAFE, by complying with certain procedural requirements. After the consummation of the acquisition of Beijing HollySys stock by Gifted Time Holdings from the HollySys Stockholders, Beijing HollySys will change from a domestic company to a Foreign Invested Enterprise that is qualified to apply for the "Foreign Exchange Registration Certificate."

The current foreign exchange measures may be changed in a way that will make payment of dividends and other distributions outside of China more difficult or unlawful. In that case, if HollySys intended to distribute profits outside of the PRC, it might not be able to obtain sufficient foreign exchange to do so.

**Gifted Time Holdings is subject to Notice 75 promulgated by SAFE, which requires PRC residents to apply for Foreign Exchange Investment Registration before establishing or controlling an OSIC. If the PRC residents do not establish and maintain the Foreign Exchange Investment Registration for Gifted Time Holdings, then Gifted Time Holdings may be prohibited from acquiring the domestic assets or shares from the PRC residents and the domestic company may not distribute profits or proceeds from a liquidation, paying bonuses to the OSIC outside of the PRC.**

On October 21, 2005, SAFE promulgated Notice 75, Notice on Issues concerning Foreign Exchange Management in PRC Residents' Financing and Return investments through Overseas Special Intention Company. Notice 75 provides that PRC residents must apply for Foreign Exchange Investment Registration before establishing or controlling an OSIC, which is defined by Notice 75 as a foreign enterprise directly established or indirectly controlled by PRC residents for foreign equity capital financing with their domestic enterprise assets and interests. Gifted Time Holdings would be considered an OSIC following the stock purchase transaction. Notice 75 requires that PRC residents process the modification of foreign investment exchange registration for the interests of net assets held by PRC residents in an OSIC and its alteration condition, if PRC residents directly contributed their domestic assets or shares into the OSIC, or processed foreign equity capital financing after directly contributing their domestic assets or shares into the OSIC.

Pursuant to Notice 75, a domestic company is prohibited, among other things, from distributing profits or proceeds from liquidation, paying bonuses to the OSIC outside of the PRC if the PRC residents have not completed or do not maintain the Foreign Investment Exchange Registration. As a result, if the stockholders who hold the 74.11% interest in Beijing HollySys fail to complete the foreign investment exchange registration and modification process, Gifted

Time Holdings may not be able to receive any profits, bonuses or proceeds from liquidation from Beijing HollySys.

**HollySys will be subject to various tax regimes, so any change in tax laws and regulations in any one of the relevant jurisdictions may result in reduced profitability and an increase in tax liabilities.**

Upon consummation of the stock purchase transaction, we will have subsidiaries and/or operations in the PRC, and the BVI, and we may soon have operations in other jurisdictions. As a result, we will be subject to the tax regimes of these countries. Any change in tax laws and regulations or the interpretation or application thereof, either internally in one of those jurisdictions or as between those jurisdictions, may adversely affect our profitability and tax liabilities.

**Being a foreign private issuer exempts us from certain Securities and Exchange Commission Requirements.**

Upon consummation of the Redomestication Merger we will be a foreign private issuer within the meaning of the rules promulgated under the Securities Exchange Act of 1934. As such, we will be exempt from certain provisions applicable to United States public companies including:

- The rules requiring the filing with the SEC of quarterly reports on Form 10-Q or current reports on Form 8-K;
- The sections of the Securities Exchange Act regulating the solicitation of proxies, consents or authorizations with respect to a security registered under the Securities Exchange Act;
- Provisions of Regulation FD aimed at preventing issuers from making selective disclosures of material information; and
- The sections of the Securities Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and establishing insider liability for profits realized from any "short swing" trading transactions (i.e., a purchase and sale, or a sale and purchase, of the issuer's equity securities within less than six months).

Because of these exemptions, our stockholders will not be afforded the same protections or information generally available to investors holding shares in public companies organized in the United States.

**Following the share purchase, a limited number of stockholders will collectively own over 77% of our common stock and may act, or prevent certain types of corporate actions, to the detriment of other stockholders.**

Immediately after the consummation of the share purchase transaction, the former holders of Gifted Time Holdings will own more than 77% of our outstanding common stock. Accordingly, these stockholders (some of whom serve as, or are affiliated with, our directors and officers) may, if they act together, exercise significant influence over all matters requiring stockholder approval, including the election of a majority of the directors and the determination of significant corporate actions. This concentration could increase if the earnout shares are issued. If all of the earnout shares are issued as additional consideration to the HollySys Stockholders, then the HollySys Stockholders will own approximately 82% of the issued and outstanding common stock of HLS, and existing Chardan stockholders will own approximately 18% of the issued outstanding common stock of HLS. This concentration could also have the effect of delaying or preventing a change in control that could otherwise be beneficial to our stockholders.

**There may not be an active, liquid trading market for our common stock, and the trading price for our common stock may fluctuate significantly.**

Our common stock is currently traded on the Over the Counter Bulletin Board, and we intend to file an application for listing on The Nasdaq National Market. Our listing application may not be accepted. If we do not succeed in securing a listing on the NASDAQ National Market, it could limit the ability to trade our common stock and result in a reduction of the price that can be obtained for shares being sold.

Compliance with all of the applicable provisions of the Sarbanes-Oxley Act will likely be a further condition of continued listing or trading. There is no assurance that if we are granted a listing on the Nasdaq National Market we will always be able to meet the Nasdaq National Market listing requirements, or that there will be an active, liquid trading market for our common stock in the future. Failure to meet the Nasdaq National Market listing requirements could result in the delisting of our common stock from the Nasdaq National Market, which may adversely affect the liquidity of our shares, the price that can be obtained for them, or both.

**Chardan's Board approved the transaction without obtaining a fairness opinion.**

Based upon the directors' extensive experience in performing due diligence of acquisition targets and in valuing companies, Chardan did not obtain a fairness opinion with respect to the stock purchase transaction. If the Chardan Board erred in concluding that the Stock Purchase Agreement is in the best interest of the Chardan stockholders, then the Chardan stockholders will suffer adverse consequences associated with the consummation of the transaction. In the event of litigation over the Board's exercise of its fiduciary duties, Chardan may be required to indemnify its directors. At a minimum, any litigation would divert management's time and attention from completing the transactions described herein, and would likely also involve the expenditure of substantial amounts for legal fees.

**We may not pay cash dividends, so the liquidity of a stockholder's investment depends on his or her ability to sell the stock at an acceptable price, and the market price of the stock may fluctuate greatly.**

We have never paid any cash dividends on our common stock, and we may not pay cash dividends in the future. Instead, we expect to apply earnings toward the further expansion and development of our business. Thus, the liquidity of your investment is dependent upon your ability to sell stock at an acceptable price, rather than receiving an income stream from it. The price of our stock can go down as well as up, and fluctuations in market price may limit your ability to realize any value from your investment, including recovering the initial purchase price.

### **FORWARD-LOOKING STATEMENTS**

We believe that some of the information in this proxy statement/prospectus constitutes forward-looking statements within the definition of the Private Securities Litigation Reform Act of 1995. However, the safe-harbor provisions of that act do not apply to statements made in this proxy statement/prospectus. You can identify these statements by forward-looking words such as “may,” “expect,” “anticipate,” “contemplate,” “believe,” “estimate,” “intends,” and “con” similar words. You should read statements that contain these words carefully because they:

- discuss future expectations;
- contain projections of future results of operations or financial condition; or
- state other “forward-looking” information.

We believe it is important to communicate our expectations to the Chardan stockholders. However, there may be events in the future that we are not able to predict accurately or over which we have no control. The risk factors and cautionary language discussed in this proxy statement/prospectus provide examples of risks, uncertainties and events that may cause actual results to differ materially from the expectations described by Chardan or Gifted Time Holdings in its forward-looking statements, including among other things:

- the number and percentage of Chardan stockholders voting against the stock purchase proposal;
- changing interpretations of generally accepted accounting principles;
- outcomes of government reviews, inquiries, investigations and related litigation;
- continued compliance with government regulations;
- legislation or regulatory environments, requirements or changes adversely affecting the businesses in which Gifted Time Holdings and the HollySys Operating Companies are engaged;
- fluctuations in customer demand;
- management of rapid growth;
- intensity of competition from other providers of crop seeds;
- timing of approval and market acceptance of new products;
- general economic conditions; and

geopolitical events and regulatory changes.

You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this proxy statement/prospectus. All forward-looking statements included herein attributable to any of Chardan, HollySys or any person acting on either party's 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, Chardan and HollySys undertake no obligations to update these forward-looking statements to reflect events or circumstances after the date of this proxy statement/prospectus or to reflect the occurrence of unanticipated events.

Before you grant your proxy or instruct how your vote should be cast or vote on the adoption of the Stock Purchase Agreement you should be aware that the occurrence of the events described in the "Risk Factors" section and elsewhere in this proxy statement/prospectus could have a material adverse effect on Chardan, Gifted Time Holdings, the HollySys Operating Companies or the combined company.

## THE CHARDAN SPECIAL MEETING

### Chardan Special Meeting

We are furnishing this proxy statement/prospectus to you as part of the solicitation of proxies by the Chardan board of directors for use at the special meeting in connection with the proposed stock purchase, Redomestication Merger and stock option plan. This document provides you with the information you need to know to be able to vote or instruct your vote to be cast at the special meeting.

### Date, Time and Place

We will hold the special meeting at \_\_\_\_ a.m., Pacific Time, on \_\_\_\_\_, 2006 at 625 Broadway, Suite 1111, San Diego, California 92101, to vote on the proposals to approve the Stock Purchase Agreement, the Redomestication Merger and stock option plan.

### Purpose of the Special Meeting

- At the special meeting, we are asking holders of Chardan common stock to:
- approve the stock purchase proposal;
- approve the Redomestication Merger proposal; and
- approve the stock option proposal.

The Chardan board of directors:

- has unanimously determined that the stock purchase proposal, the Redomestication Merger proposal and the stock option proposal are fair to and in the best interests of Chardan and its stockholders;
- has unanimously approved the stock purchase proposal, the Redomestication Merger proposal and the stock option proposal;
- unanimously recommends that Chardan common stockholders vote "FOR" the proposal to adopt the Stock Purchase Agreement,
- unanimously recommends that Chardan common stockholders vote "FOR" the proposal to redomesticate in the British Virgin Islands; and

·unanimously recommends that Chardan common stockholders vote “FOR” the proposal to adopt the stock option plan.

### **Record Date; Who is Entitled to Vote**

The “record date” for the special meeting is \_\_\_\_\_, 2006. Record holders of Chardan common stock at the close of business on the record date are entitled to vote or have their votes cast at the special meeting. On the record date, there were 7,000,000 outstanding shares of Chardan common stock.

Each share of Chardan common stock is entitled to one vote per share at the special meeting.

Pursuant to agreements with Chardan, any shares of Chardan common stock held by stockholders who purchased their shares of common stock prior to the initial public offering (except for shares those holders may have purchased in the public market) will be voted in accordance with the majority of the votes cast at the special meeting on the stock purchase and Redomestication Merger proposals.

Chardan’s outstanding warrants do not have any voting rights, and record holders of Chardan warrants will not be entitled to vote at the special meeting.

### **Voting Your Shares**

Each share of Chardan common stock that you own in your name entitles you to one vote. Your proxy card shows the number of shares of Chardan common stock that you own.

There are three ways to vote your shares of Chardan common stock at the special meeting:

- *You can vote by signing and returning the enclosed proxy card.* If you vote by proxy card, your “proxy,” whose name is listed on the proxy card, will vote your shares as you instruct on the proxy card. If you sign and return the proxy card but do not give instructions on how to vote your shares, your shares will be voted as recommended by the Chardan board “**FOR**” the adoption of the stock purchase proposal, the Redomestication Merger proposal, and the stock option plan proposal.
- You can vote by telephone or on the internet by following the telephone or Internet voting instructions that are included with your proxy card. If you vote by telephone or by the Internet, you should not return the proxy card.
- *You can attend the special meeting and vote in person.* We will give you a ballot when you arrive. However, if your shares are held in the name of your broker, bank or another nominee, you must get a proxy from the broker, bank or other nominee. That is the only way we can be sure that the broker, bank or nominee has not already voted your shares.

**IF YOU DO NOT VOTE YOUR SHARES OF CHARDAN COMMON STOCK IN ANY OF THE WAYS DESCRIBED ABOVE, IT WILL HAVE THE SAME EFFECT AS A VOTE AGAINST THE ADOPTION OF THE STOCK PURCHASE PROPOSAL AND THE REDOMESTICATION MERGER PROPOSAL, BUT WILL NOT HAVE THE EFFECT OF A DEMAND OF CONVERSION OF YOUR SHARES INTO A PRO RATA SHARE OF THE TRUST ACCOUNT IN WHICH A SUBSTANTIAL PORTION OF THE PROCEEDS OF CHARDAN’S INITIAL PUBLIC OFFERING ARE HELD OR A DEMAND FOR APPRAISAL RIGHTS UNDER DELAWARE LAW.**

### **Who Can Answer Your Questions About Voting Your Shares**

If you have any questions about how to vote or direct a vote in respect of your Chardan common stock, you may call Dr. Richard D. Propper, Chardan’s chairman, (619) 795-4627.

**Broker Non-Votes.**

A broker non-vote occurs when a broker submits a proxy card with respect to shares held in a fiduciary capacity (typically referred to as being held in “street name”) but declines to vote on a particular matter because the broker has not received voting instructions from the beneficial owner. Under the rules that govern brokers who are voting with respect to shares held in street name, brokers have the discretion to vote such shares on routine matters, but not on non-routine matters. Routine matters include the election of directors and ratification of auditors. The matters currently planned to be considered by the shareholders are not routine matters. As a result, brokers can only vote the Chardan shares if they have instructions to do so. Abstentions and broker non-votes will not be counted in determining whether the proposals to be considered at the meeting are approved.

### **No Additional Matters May Be Presented at the Special Meeting**

This special meeting has been called only to consider the adoption of the stock purchase proposal, the Redomestication Merger proposal and the stock option proposal. Under Chardan's by-laws, other than procedural matters incident to the conduct of the meeting, no other matters may be considered at the special meeting, if they are not included in the notice of the meeting.

### **Revoking Your Proxy**

If you give a proxy, you may revoke it at any time before it is exercised by doing any one of the following:

- You may send another proxy card with a later date;
- You may notify Dr. Propper, Chardan's chairman, in writing before the special meeting that you have revoked your proxy; and
- You may attend the special meeting, revoke your proxy, and vote in person, as indicated above.

### **Vote Required**

The presence, in person or by proxy, of a majority of all the outstanding shares of common stock constitutes a quorum at the special meeting. Proxies that are marked "abstain" and proxies relating to "street name" shares that are returned to Chardan but marked by brokers as "not voted" will be treated as shares present for purposes of determining the presence of a quorum on all matters. The latter will not be treated as shares entitled to vote on the matter as to which authority to vote is withheld by the broker ("broker non-votes"). If you do not give the broker voting instructions, under the rules of the NASD, your broker may not vote your shares on the proposals to approve the stock purchase, the Redomestication Merger or the stock option plan.

The approval of the stock purchase and Redomestication Merger proposals will require the affirmative vote of the holders of a majority of the Chardan common stock outstanding on the record date. Because each of these proposals require the affirmative vote of a majority of the shares of common stock outstanding and entitled to vote, abstentions and shares not entitled to vote because of a broker non-vote will have the same effect as a vote against the proposal. Under Chardan's Certificate of Incorporation, approval of the stock purchase also requires approval of a majority of the shares issued in Chardan's initial public offering in August 2005. Since stockholders of Chardan prior to the initial public offering have agreed to vote their shares in accordance with the vote of a majority of the shares issued in the initial public offering, the required approval of a majority of shares outstanding will be achieved if, and only if, a majority of the shares issued in the initial public offering vote in favor of the proposals.

For consummation of the Stock Purchase Agreement, the Redomestication Merger proposal must be approved by the stockholders. For the Redomestication Merger to be implemented, the stock purchase proposal must be approved by the stockholders.

The approval of the stock option plan will require the affirmative vote of a majority of the Chardan common stock present and entitled to vote at the meeting. Abstentions are deemed entitled to vote on the proposal, therefore, they have the same effect as a vote against the proposal. However, broker non-votes are not deemed entitled to vote on the proposal, so, they will have no effect on the vote on the proposal.

### **Conversion Rights**

Any stockholder of Chardan holding shares of common stock issued in Chardan's initial public offering who votes against the stock purchase proposal may, at the same time, demand that Chardan convert his or her shares into a pro rata portion of the trust account as of the record date. If the stockholder makes that demand and the stock purchase is consummated, Chardan will convert these shares into a pro rata portion of funds held in the trust account plus interest, as of the record date. A stockholder who has not properly exercised conversion rights may still exercise those rights prior to the special meeting by submitting a later dated proxy, together with a demand that Chardan convert his or her shares. After the special meeting, a Chardan stockholder may not exercise conversion rights or correct invalidly exercised rights.

The closing price of Chardan's common stock on \_\_\_\_\_, 2006 (the record date) was \$\_\_\_\_\_ and the per-share, pro-rata cash held in the trust account on that date was approximately \$\_\_\_\_\_. Prior to exercising conversion rights, Chardan stockholders should verify the market price of Chardan's common stock as they may receive higher proceeds from the sale of their common stock in the public market than from exercising their conversion rights, if the market price per share is higher than the conversion price.

If the holders of 1,150,000 or more shares of common stock issued in Chardan's initial public offering (an amount equal to 20% or more of these shares), vote against the stock purchase and demand conversion of their shares, Chardan will not be able to consummate the stock purchase.

If you exercise your conversion rights, then you will be exchanging your shares of Chardan common stock for cash and will no longer own these shares. You will be entitled to receive cash for these shares only if you continue to hold these shares through the effective time of the stock purchase and then tender your stock certificate to the combined company. Exercise of conversion rights will not affect any warrants held by that stockholder.

### **Appraisal Rights**

Under Delaware corporate law, the Redomestication Merger of Chardan with HLS causes the stockholders of Chardan to have appraisal rights in connection with the transactions for which approval is sought. This right is separate from the conversion rights of the holders of shares of Chardan common stock issued in the initial public offering. However, because the exercise of the appraisal right and the conversion rights both require a tender of the holder's shares to Chardan, only one right may be elected in respect of the shares. If the merger is consummated, Chardan stockholders who choose not to vote in favor of the merger will have the right to elect an appraisal of the fair market value of their shares of Chardan common stock, and to receive the fair market value of such shares in lieu of the consideration contemplated by the merger and the merger agreement, in accordance with the provisions of Section 262 of the Delaware General Corporation Law. Unlike conversion rights in which the stockholder will receive a pro rata portion of the trust account as of the record date, stockholders who elect to exercise their appraisal rights will receive a value for their shares that is determined by an appraisal made by the Delaware Court of Chancery. Failure to properly exercise appraisal rights before the special meeting will result in loss of these rights. Exercise of appraisal rights will not affect any warrants held by that stockholder. See Annex H for more information about appraisal rights.

### **Solicitation Costs**

Chardan is soliciting proxies on behalf of the Chardan board of directors. This solicitation is being made by mail but also may be made by telephone or in person. Chardan and its respective directors, officers and employees may also solicit proxies in person, by telephone or by other electronic means. In addition, the representatives and officers of HollySys are soliciting proxies and may solicit proxies in person, by telephone or by other electronic means. These persons will not be paid for these solicitation activities.

Chardan has not hired a firm to assist in the proxy solicitation process, but may do so if it deems this assistance necessary. Chardan will pay all fees and expenses related to the retention of any proxy solicitation firm.

Chardan will ask banks, brokers and other institutions, nominees and fiduciaries to forward its proxy materials to their principals and to obtain their authority to execute proxies and voting instructions. Chardan will reimburse them for their reasonable expenses.

### **Stock Ownership**

At the close of business on the record date, Dr. Richard D. Propper, Kerry S. Propper, Jiangnan Huang, and Li Zhang, beneficially owned and were entitled to vote approximately 1,250,000 shares of Chardan common stock, or

approximately 17.9% of the then outstanding shares of Chardan common stock, which includes all of the shares held by the directors and executive officers of Chardan and their affiliates. Those persons, who were stockholders of Chardan prior to its initial public offering of securities, have agreed to vote their shares (except for any shares they may have acquired in the public market) on the stock purchase and Redomestication Merger proposals in accordance with the majority of the votes cast by the holders of shares issued in Chardan's initial public offering.

## **Fairness Opinion**

Chardan did not obtain a fairness opinion in respect of the acquisition of HollySys or the Redomestication Merger.

## **CONSIDERATION OF THE STOCK PURCHASE TRANSACTION**

The following discussion of the principal terms of the Stock Purchase Agreement dated February 2, 2006 among Chardan and the HollySys Stockholders is subject to, and is qualified in its entirety by reference to, the Stock Purchase Agreement. A copy of the Stock Purchase Agreement is attached as an annex to this proxy statement/prospectus and is incorporated in this proxy statement/prospectus by reference.

### **General Description of the Stock Purchase**

Pursuant to the Stock Purchase Agreement, Chardan has established a wholly owned subsidiary, HLS Systems International Ltd., under the laws of the British Virgin Islands, and Chardan will merge with and into HLS concurrently with the closing of the stock purchase. HLS will be the surviving entity, and the separate corporate existence of Chardan will cease at the effective time of the merger. Simultaneously with the merger, HLS will purchase all of the issued and outstanding stock of Gifted Time Holdings, which in turn will own, or will have acquired the rights to control, 74.11% of the outstanding stock of Beijing HollySys Co., Ltd. and 89.64% of the outstanding stock of Hangzhou HollySys Automation Co., Ltd., including 29.64% owned by virtue of the fact that Beijing HollySys owns 40% of Hangzhou HollySys. We refer to HLS Systems International Ltd., after giving effect to completion of the stock purchase, as “HLS” or “the combined company.” As a result of the stock purchase, the former owners of Gifted Time Holdings will own approximately 77% of the outstanding shares of the combined company’s common stock, assuming no conversions or exercise of appraisal rights and before any issuance of shares pursuant to the earn out provisions of the Stock Purchase Agreement. If HLS issues the additional earnout shares as additional consideration to the HollySys Stockholders, then the HollySys Stockholders will own approximately 82% of the issued and outstanding common stock of HLS, and existing Chardan stockholders will own approximately 18% of the issued outstanding common stock of HLS. None of the foregoing percentages reflects the effect that an exercise of the currently outstanding warrants would have.

The parties to the Stock Purchase Agreement include Shanghai Jinqiaotong Industrial Development Co., Wang Changli, Cheng Wusi, Lou An, Team Spirit Industrial Limited and OSCAF International Co. Ltd. Shanghai Jinqiaotong Industrial Development Co., Wang Chang li, Cheng Wusi and Lou An are stockholders of Beijing HollySys, and Team Spirit and OSCAF are stockholders of Hangzhou HollySys. Shanghai Jinqiaotong owns 20% of the total shares of Beijing HollySys. Wang Changli, Cheng Wusi and Lou An respectively own 14.23%, 30% and 9.88% of the total shares of Beijing HollySys. Wang Changli, Cheng Wusi and Lou An entered into a voting agreement in which Lou An and Cheng Wusi agreed to vote in concert with Wang Changli during the period from December 1, 2004 to December 31, 2006. On July 15, 2005, Shanghai Jinqiaotong entered into an Acknowledgement Letter in which it agreed to completely accept and follow the terms and conditions of the Voting Agreement signed by Wang Changli, Cheng Wusi and Lou An. Team Spirit and OSCAF each owned 30% of the total shares of Hangzhou HollySys, and both parties transferred their entire equity interest in Hangzhou HollySys to Gifted Time Holdings pursuant to share transfer agreements executed on January 12, 2006 in exchange for stock in Gifted Time Holdings.

### **Background of the Stock Purchase**

The terms of the Stock Purchase Agreement are the result of arm’s-length negotiations between representatives of Chardan and the HollySys Stockholders. The following is a brief discussion of the background of these negotiations, the stock purchase and related transactions.

Chardan was formed on March 10, 2005 to serve as a vehicle to accomplish a business combination with an unidentified operating business in the PRC that has its primary operating facilities located in any city or province north of the Yangtze River. Chardan completed an initial public offering on August 10, 2005, in which it raised net proceeds of approximately \$30 million. Of these net proceeds, approximately \$29.8 million were placed in a trust account immediately following the initial public offering and, in accordance with Chardan's Certificate of Incorporation, will be released either upon the consummation of a business combination or upon the liquidation of Chardan. Chardan must liquidate unless it has consummated a business combination by February 10, 2007. If a letter of intent, agreement in principle or a definitive agreement to complete a business combination was executed but the transaction was not consummated prior to February 10, 2005, then it is not required to liquidate unless the business combination contemplated by such letter of intent, agreement in principle or definitive agreement is not consummated by August 10, 2007.

In mid-August 2005, promptly after completing Chardan's public offering, the officers and directors of Chardan traveled to China to begin the initial interviewing and screening process to locate a company with which to effect a business combination. Chardan initially sought to identify acquisition candidates principally through the efforts of Huang Jiangnan and Li Zhang, officers and directors of Chardan. Both of these persons have extensive contacts through the Chinese business and legal community in the PRC. In addition, Chardan began looking at companies introduced by both the Guantao Law Firm and Chum Investment Corporation. They helped to arrange meetings with several candidates during that approximately ten-day trip. Among the candidates that were interviewed during that trip was HollySys.

In addition, Chardan began looking at companies introduced by both the Guantao Law Firm ("Guantao") and Chum Investment Corporation ("Chum"). Chum had introduced State Harvest Holdings, Ltd. to Chardan China Acquisition Corp. (now Origin Agritech, Ltd.), another blank check company that successfully concluded a business combination with State Harvest Holdings, Ltd. and that had the same officers and directors as Chardan. Chum was aware that the management of Chardan China Acquisition Corp. had organized Chardan, and without a request from Chardan, Chum explored with several Chinese companies whether they might have an interest in a business combination with Chardan. At no time did Chum or anyone else provide Chardan with the identity of or any information about the potential candidates until after Chardan's public offering was concluded on August 10, 2005. Aware that Chardan's public offering had closed on August 10, 2005, Chum helped to arrange meetings between Chardan and several candidates during an approximately ten-day trip to China by Chardan's officers in mid-August. Among the candidates introduced by Chum to Chardan on that trip was HollySys. Chardan first learned that Chum was proposing a business combination between HollySys and Chardan only after the officers of Chardan arrived in China on August 13, 2005.

To assist Chardan in evaluating companies in the PRC, Chardan put Jiangnan Huang, an officer and director of Chardan, in contact with Greatace Consultants Limited ("Greatace"), a Chinese business acquisition consulting firm, on August 28, 2005. Mr. Huang was familiar with Mr. Rong Deng, the chief executive of Greatace, through a common friend, but Chardan, its officers and directors have no other relationship with or connection to Greatace. On September 1, 2005, Chardan engaged Greatace to assist it in preparing background investigations, industry analysis and due diligence reports, among other things, on potential acquisition candidates. Chardan did not retain Greatace to identify candidates for a business combination, and Greatace did not propose any such candidates to Chardan. Under the terms of the agreement, Greatace will be paid a total of \$200,000, payable in four installments. The first three installments of \$22,200, \$22,200 and \$22,300 have been paid as milestone payments for a due diligence report on the first company that Chardan targets as an acquisition candidate. The remaining \$133,300 will be paid upon the successful consummation of a business transaction with an operating entity in the PRC.

The services that Greatace provided included assisting in preparing and executing required confidentiality, market stand-off and similar agreements; compiling preliminary information about merger candidates; performing financial due diligence and analysis; recommending acquisition structures; assessing the information about the potential target that is available and working with accountants and legal staff to prepare for a business combination, including agreement negotiation.

Chardan, using information it had acquired during its meetings and afterward, selected five companies as potential candidates for a business combination, and Chardan requested preliminary reports from Greatace evaluating of the potential targets. On October 7, 2005, Greatace and the Chardan team held a meeting to review the data collected on various potential targets and meet with representatives of some of these companies. On the basis of the information provided by Greatace in the review and meetings, in October 2005 Chardan selected HollySys as the candidate with which to pursue an agreement.

The Chardan representatives first met with HollySys' President, Dr. Wang Changli and Chairman, Madame Qiao Li, on August 17, 2005 and again on August 22, 2005, for preliminary discussions about a potential business combination. For some time thereafter, the parties remained in contact through occasional phone calls and email

communications, both directly and through their respective representatives.

The first formal meeting to discuss this transaction was held on October 10, 2005, in Beijing, China. Chardan management, HollySys management and an advisory firm for HollySys, Chum Investment Corporation, exchanged information about Chardan and HollySys and suggested a general structure and terms of an acquisition by Chardan. In addition, preliminary issues of due diligence, exchange of information and pricing were also discussed.

During its discussions with HollySys, Chardan and Greatace continued to evaluate other potential candidates for a business combination.

On November 18, 2005, Dr. Propper, Mr. Huang and Mr. Zhang from Chardan and the HollySys Stockholders, including representatives of Chum Investment Corporation, met in Beijing for further discussions about the respective businesses and terms of the transaction. The parties were in general agreement about the acquisition terms, but at this meeting they began to discuss various specifics and raised topics related to the acquisition and disclosure process.

After two days of negotiations and due diligence review in Beijing from November 18 to November 19, 2005 (by and among Dr. Propper, Mr. Zhang Li and Mr. Jiangnan Huang of Chardan and Dr. Wang Changli and Madame Qiao Li of HollySys), Chardan signed a non-binding memorandum of understanding on November 27, 2005 with respect to acquiring a controlling interest in HollySys. This memorandum set forth the following:

- the reorganization of HollySys which was to take into account the best tax arrangements for all parties;
- the consideration to be paid for HollySys, which is reflected in the Stock Purchase Agreement;
- the terms of the additional consideration to be paid over time based on performance criteria;
- the desire for a stock option plan; and
- the inclusion of certain HollySys Stockholders on the board of directors of the surviving corporation.

Promptly after the execution of the memorandum of understanding, Chardan's United States counsel prepared a draft of the Stock Purchase Agreement and sent it to counsel for HollySys. In addition, the Chinese counsel of Chardan consulted with Chinese counsel for HollySys and commenced discussion of the structure of the transaction and the anticipated steps to be completed before agreement could be reached.

During the period between November 28, 2005 and December 10, 2005, counsel exchanged emails about various points in the agreements and continued to modify them and exchanged drafts of documents. Counsel and the accountants for all the parties conducted legal and financial due diligence and negotiated points in the agreements. During this period, representatives of Chardan and HollySys also conducted further due diligence.

On December 10, 2005, there was a meeting at the offices of Chardan's United States counsel, DLA Piper Rudnick Gray Cary, in San Diego, to negotiate the final terms of Stock Purchase Agreement. Dr. Propper and Mr. Zhang of Chardan and Chardan's United States counsel attended the meetings in person. Dr. Wang Changli and Madame Qiao Li of HollySys, Mr. Song Xuesong, executive director of Chum Investment Corporation, advisor to HollySys, and Mr. Cui and Mr. Sun, partners of Guantao Law Firm, counsel to HollySys, attended the meeting in person as well. Substantial progress was made on the agreements at that time. Following the meetings in San Diego, legal counsel for the respective parties continued to exchange comments and drafts of the contract documents for the transaction.

On December 19, 2005, representatives of Greatace met with the board of directors of Chardan to give a report of their due diligence of HollySys and analysis of the business in which HollySys operates. At the meeting were all the board members of Chardan and Mr. Gu Robert, representing Greatace, who made the report. The board of directors unanimously resolved to proceed with the acquisition process and continue to work towards execution of a definitive Stock Purchase Agreement.

On January 31, 2006 the board of directors of Chardan met to review the transaction documents and evaluate and approve the acquisition of HollySys. The board of directors reviewed the latest forms of Stock Purchase Agreement, the stock consignment agreements, and the employment agreements. The board of directors also reviewed the disclosure schedules to the Stock Purchase Agreement. After further review of the due diligence materials, the foregoing were unanimously approved, subject to final negotiation and modification, and the board determined to recommend the approval of the Stock Purchase Agreement, Redomestication Merger and related transactions and the

stock option plan to the stockholders.

While Dr. Wang and the other representatives of HollySys were in San Diego from December 10, 2005 to December 14, 2005, Dr. Propper and counsel for Chardan reviewed with them the obligations of being a reporting company, including compliance with the reporting requirements of the federal securities laws, accounting procedures and Sarbanes Oxley requirements, press release disclosure and timing, shareholder communications, website disclosure, financial public relations, NASDAQ compliance and transfer agent requirements. Dr. Wang asked if Chardan Capital LLC could help the post-transaction company in advising and complying with all the various requirements until management and the service providers in the PRC were familiar with the rules and regulations and public company demands. On December 10, 2005, at a meeting in the offices of Chardan's legal counsel, the consulting arrangement between Chardan Capital LLC and HollySys was agreed to. Because it is to last only until the HollySys management was familiar with the requirements of being public, it will be terminable at HollySys' discretion, without penalty. The monthly fee was determined to be \$30,000. This arrangement has not been reduced to a written agreement.

The Stock Purchase Agreement was signed on February 2, 2006. Chardan issued a press release that date and filed a Current Report on Form 8-K on February 3, 2006 announcing the execution of the agreement and discussing the terms of the stock purchase.

Effective as of March 25, 2006 and June 5, 2006, the Parties amended the Stock Purchase Agreement. Copies of the amendments to the Stock Purchase Agreement are contained in Annex A.

### **Board Consideration and Approval of Transaction**

While no single factor determined the final agreed upon consideration in the stock purchase, Chardan's board of directors reviewed various industry and financial data, including certain valuation analyses and metrics compiled by members of the board and by Greatace in order to determine that the consideration to be paid to the HollySys Stockholders was reasonable and that the stock purchase was in the best interests of Chardan's stockholders.

Greatace, a Chinese consulting firm hired by Chardan to assist in identifying and screening candidates for a business combination, conducted a due diligence review of HollySys and the HollySys Operating Companies that included an industry analysis, a description of HollySys' existing business model and business operations, and financial projections in order to enable the board of directors to ascertain the reasonableness of this range of consideration. Throughout the negotiation process, Greatace continued to assemble and review relevant due diligence materials and, on November 19, 2005, delivered a due diligence package that included the information regarding HollySys and the HollySys Operating Companies that Greatace had gathered and prepared. During its negotiations with the HollySys Stockholders, Chardan did not receive services from any financial advisor other than Greatace.

### ***Interest of Chardan Directors and Officers in the Stock Purchase***

In considering the recommendation of the board of directors of Chardan to vote for the proposals to approve the Stock Purchase Agreement, the Redomestication Merger and the stock option plan, you should be aware that certain members of the Chardan board have agreements or arrangements that provide them with interests in the stock purchase that differ from, or are in addition to, those of Chardan stockholders generally. In particular:

- if the stock purchase is not approved and Chardan fails to consummate an alternative transaction within the time allotted pursuant to its Certificate of Incorporation, Chardan would be required to liquidate. In such event, the shares of common stock held by Chardan's directors and officers would be worthless because Chardan's directors and officers are not entitled to receive any of the liquidation proceeds, and any warrants they hold will expire worthless.
- Chardan's executives and directors own a total 1,250,000 shares of Chardan common stock that have a market value of \$\_\_\_\_\_ based on Chardan's share price of \$\_\_\_\_\_ as of \_\_\_\_\_, 2006. However, as Chardan's directors and executives are contractually prohibited from selling their shares prior to August 2, 2008 (during which time the value of the shares may increase or decrease), it is impossible to determine what the financial impact of the stock purchase will be on Chardan's directors and executives;
- the transactions contemplated by the Stock Purchase Agreement provide that Kerry S. Propper will be a director of HLS;
- after completion of the stock purchase, Chardan Capital LLC, an affiliate of Dr. Propper, Mr. Zhang and Mr. Huang, will provide a variety of ongoing services to HollySys. Such services will be provided on a month-to-month basis terminable at will by HollySys without penalty, at a cost to HollySys of \$30,000 per month. There is no written agreement governing the services to be provided, which will be on a non-exclusive basis and include advice and help in meeting US public reporting requirements and accounting standards, Sarbanes-Oxley compliance, corporate structuring and development, stockholder

relations, corporate finance and operational capitalization and such other similar services as suggested and agreed to by Chardan Capital, LLC.

***Chardan's Reasons for the Stock Purchase and Recommendation of the Chardan Board***

The Chardan board of directors concluded that the Stock Purchase Agreement with the HollySys Stockholders is in the best interests of Chardan's stockholders. The Chardan board of directors did not obtain a fairness opinion.

Each member of Chardan's board of directors has previous experience in performing due diligence of acquisition targets and in valuing companies, including Chinese companies. Three of the directors, Dr. Propper and Messrs. Li and Huang, are currently principals in Chardan Capital LLC, a strategic financial and management consulting company that focuses on identifying attractive Chinese companies and in structuring transactions involving those companies. One director, Mr. Kerry Propper, is the Chief Executive Officer of Chardan Capital Markets, a registered NASD broker dealer.

Recent relevant experience of Chardan's management includes their successful conclusion of the acquisition of State Harvest Holdings, Ltd. by Chardan China Acquisition Corp. (now Origin Agritech, Ltd.) and a reverse merger between Diguang International Development Co., Ltd. (formerly Online Processing, Inc.) and Diguang International Holdings, Limited, a British Virgin Islands holding company whose Chinese operating subsidiary is engaged in the production of backlights for liquid crystal displays used in appliances and consumer electronics. With regard to the latter transaction, Dr. Propper and Messrs. Zhang and Huang participated as principals of Chardan Capital, LLC, and Mr. Propper participated by virtue of the fact that Chardan Capital Markets, LLC (which is not affiliated in any way with Chardan Capital, LLC) acted as a placement agent for a \$12 million private placement that occurred in connection with that reverse merger.

The Chardan board of directors considered a wide variety of factors in connection with its evaluation of the stock purchase. In light of the complexity of those factors, the Chardan board of directors did not consider it practicable to, nor did it attempt to, quantify or otherwise assign relative weights to the specific factors it considered in reaching its decision. In addition, individual members of the Chardan board may have given different weight to different factors.

In considering the stock purchase, the Chardan board of directors gave considerable weight to the factors discussed below.

***HollySys' and the HollySys Operating Companies' record of growth and expansion and high potential for future growth***

Important criteria to Chardan's board of directors in identifying an acquisition target were that the company have established business operations, that it was generating current revenues and profits, and that it have what Chardan believes to be a potential to experience growth in the future.

Chardan's board of directors believes that HollySys and the HollySys Operating Companies have in place the infrastructure for good business operations, a large and growing customer base, technological capabilities and brand name recognition. HollySys commenced business operations in 1996. It has substantial revenues (approximately \$80 million for fiscal 2005), and its revenue growth has averaged greater than 47% from 2003 through 2005. Based on the number and type of contracts currently being performed, HollySys anticipates revenues for all of fiscal 2006 (ending June 30, 2006) will be approximately \$110 million.

Although revenue projections are inherently uncertain, the nature of HollySys's business makes its near term projections reasonably reliable. That is due to the fact that the large majority of the company's revenues are derived from integrated services contracts that are performed over a period of months or in some cases years. These contracts have performance schedules associated with them that makes both the amount of work on hand and the timing of the recognition of revenue associated with that work to be ascertainable with a higher degree of confidence than is possible in many industries. Although the annual revenue projection was made several months ago, the reviewed

financial results for the fiscal quarter and nine months ending March 31, 2006 show HollySys to be on track to hit that projection.

Chardan's board of directors believes that HollySys and the HollySys Operating Companies have the ability to continue the growth that they have demonstrated over the past several years for a variety of reasons, including:

- HollySys has risen to a leadership position in the Chinese automation industry in the nine plus years that it has been in operation. According to China Industrial Control Network (CICN), HollySys ranks second to ABB in the Chinese distributed control systems market;

- The prospect that China's industrial expansion, which creates demand for HollySys' products, will continue for the foreseeable future, creating the opportunity of increased growth even if HollySys simply maintains its domestic market share, and providing even more rapid growth if HollySys continues to gain market share;
- The acceptance of HOLLiAS, the company's platform technology introduced in 2004, which has helped to fuel its subsequent growth. This integrated, enterprise-wide management information and control system differentiates HollySys from many of its competitors;
- HollySys' emphasis on maintaining high levels of engineering staff and its rapid development of new products should enable it to continue to enhance its position relative to its international competitors;
- HollySys' entry into the international market, which will significantly increase the opportunity for sales of its products. Having demonstrated that its product quality is acceptable to western and Asian companies such as BASF and Toshiba, HollySys's comparative cost advantages, due to the low salary and wage structure in China relative to its Japanese and western competitors, should enable HollySys to compete effectively in those markets, helping to sustain the expansion of its business.

***HollySys represents an opportunity to invest in a growing, dynamic industry***

Another criterion important to Chardan's board of directors in selecting an acquisition target was that the company be in an emerging or expanding industry with potential for growth. While the automation industry has been in existence for a many decades, the industry is undergoing a shift from analog to digital technologies that the widespread adoption of computers has enabled. The more effective, rapid and precise degree of data collection, transmission, analysis and response that is possible with digital technologies permits a broader application of control technologies to more processes and more aspects of each process. The resulting increase in capabilities for control systems not only opens up new industrial segments as potential customers, but it also leads to opportunities for the upgrade and replacement of legacy systems by newer, more capable and reliable systems. This continued expansion of the automation industry is reflected by the fact that global spending on distributed control systems is expected to grow from \$10.3 billion in 2004 to \$14 billion by 2009.

The expansion of the industrial sector of the Chinese economy, which is the current principal market for HollySys' products, is expected to continue at a rapid rate. That will give HollySys the opportunity to expand its customer base and revenues. Even globalization has contributed to growth opportunities. Manufacturers face increasing pressure to deliver consistent quality at low cost, results that they can achieve only with the use of sophisticated control systems that are increasingly available from the suppliers of industrial automation equipment, including HollySys.

For more information on the Chinese and global industrial automation markets, see "Information about the HollySys Operating Companies," Market Overview, at page 93.

***The experience of HollySys' management***

Another criterion important to Chardan's board of directors in identifying an acquisition target was that the company have a seasoned management team with specialized knowledge of the markets within which it operates and the ability to lead a company in a rapidly changing environment. Chardan's board of directors concluded that HollySys' management has demonstrated that ability, addressing critical issues such as the development of its HOLLiAS product platform, its emphasis on rapid product development and deployment and its savvy marketing strategy, which targets its products and services to China's most rapidly growing and underserved segments, such as nuclear power and rail transportation. By utilizing its growing revenues to expand its market share and develop additional products, HollySys' management has demonstrated a commitment to a strategy that has given it a significant presence in the automation and controls industry in the PRC. The excellent English skills and western work experience of HollySys' chief

executive, Wang Changli, were also judged to be factors supporting the company's plans to expand internationally and of help in keeping the investing public effectively apprised of what is taking place with the company.

***HollySys' ability to execute its business plan, even with the risk that a significant number of Chardan's public stockholders would vote against the stock purchase and exercise their conversion rights***

Chardan's board of directors considered the risk that nearly 20% of the current public stockholders of Chardan could vote against the stock purchase and demand to redeem their shares for cash without preventing the transaction from closing. The result would be to deplete the amount of cash available to the combined companies following the stock purchase or cause a condition of the Stock Purchase Agreement not to be met. Chardan structured the payment terms in the Stock Purchase Agreement to reflect this possibility by deferring some of the cash portion of the consideration. Chardan's board of directors deemed this risk to be no worse with regard to HollySys than it would be for other target companies and believes that HollySys will still be able to implement its business plan, even if the maximum number of shares that can be converted into a pro rata portion of the trust account and still have the transaction proceed are so converted.

***Due Diligence Information Materials***

In performing the analysis described above, Chardan's board of directors also reviewed an information statement prepared by Chardan's consultants, Greatace, in connection with its search for a suitable target company.

The Greatace material provided information on the history and growth of HollySys, a detailed review of its products and markets (both current and planned) and information regarding the company's competitive position in the Chinese market, both with respect to international competitors and domestic Chinese competitors.

The Greatace due diligence report examined the automation industry in China and provided a market analysis. The report described the growth of the Chinese automation industry, particularly the Distributed Control Systems ("DCS") market. The report reviewed the market segments within the automation industry that HollySys had identified as areas of focus, and noted that HollySys has developed different product lines designed to meet the specific needs of each of these market segments. The report provided a market analysis and description of trends in these market segments and a description of HollySys' background and technology in these markets. A separate section examined the other major companies in these markets and HollySys' competition in the automation system industry, particularly in the DCS market, the nuclear power market and the railway transportation market.

The Greatace due diligence report described HollySys' core technologies and how it planned to implement its corporate business strategy toward becoming the market leader in the Chinese automation industry. A section of the report summarized HollySys' operations within its principal business units, including how they generate revenue, the profitability, growth rate and the relevant economic factors that affect their results.

The report then examined HollySys' business operations, including employee compensation and benefits, customer geographic locations and industries, sales and distribution channels, product research and development, pricing policy, advertising and marketing, material procurement control and supply, quality control and project management. The report provided additional information regarding HollySys' financial performance from 2003 to 2005 by analyzing the financial statements for those years. The report also discussed projected operating results for 2006 to 2010 provided by HollySys.

The report noted that the HollySys Stockholders had warranted to Greatace that the HollySys Operating Companies are not involved in or threatened with any legal proceedings. The report provided information on the intellectual property owned by HollySys, including eight licenses and trade certificates, 39 authorized patents, 15 software copyrights and 18 registered trademarks. The report also provided information on the real property owned by the HollySys Operating Companies..

Mr. Kerry Propper, a director and officer of Chardan, prepared for the board of directors an analysis of the post-transaction value of the HollySys Operating Companies. He analyzed comparable companies in the automation and controls markets, taking into account their relative market presences and maturity. He prepared a list of comparative price/earnings ratios of these companies and compared them to the price/earnings of the HollySys Operating Companies and their anticipated price/earnings. The valuation for the future of the HollySys Operating Companies was based on various assumptions, including projected sales, assumed margins, and projected net income. Capital resources were taken into account, based on the capital of the company after the acquisition and for income and reinvestment, and for the potential of exercise of outstanding warrants of Chardan. Based on this analysis, Mr. Propper concluded that, comparatively speaking, the enterprise value of the HollySys Operating Companies, immediately after the acquisition, was favorable. On the basis of the analysis, he concluded that the board of directors, from an economic point of view, should consider the acquisition of the Gifted Time Holdings.

Chardan's board of directors also considered the methods by which Gifted Time Holdings may own or control Beijing HollySys. Gifted Time Holdings' ownership of HollySys is, in part, through consignment agreements that transfer to it

all of the incidents of ownership (except for legal title) of a portion of the issued and outstanding stock of Beijing HollySys. Gifted Time Holdings accepted this form of ownership rather than legal title because there were legal restrictions on the transfer of title of some of the Beijing HollySys stock then held by certain of the stockholders of Gifted Time Holdings. In structuring the transaction and in preparing the documentation governing it, Chardan consulted with its legal counsel, which has offices in the PRC, for advice on the use of such consignment agreements as a means for acquiring stock of a PRC company when that stock is subject to transfer restrictions. Chardan believes that the stock consignment agreements are widely used in these instances, and Chardan's counsel had the consignment agreements involved in this transaction reviewed in its Beijing office.

Although the consignment agreements operate initially as control arrangements (e.g., granting the right to vote the shares covered by the agreement), they provide for transfer of title in the future if and when the restrictions on transfer are no longer applicable. Such transfer of title is to be made without payment of any further consideration by the consignee. Moreover, the consignment agreements prevent the title holder from transferring the shares to another party or taking any action limiting the rights granted to the consignee in the agreements. As a result, the consignment agreement freezes the ownership in the hands of the record/title owner but gives the consignee (Gifted Time) all the incidents of ownership, including voting, dividend, director nomination, management selection and every other right of ownership, other than record ownership.

Under the consignment agreements, transfer of record ownership is subject to the directions of the consignee. If the consignee requires the consignor to transfer the record ownership of the consigned securities, the consignee and consignor will enter into a Shares Transfer Agreement and apply for approval of such transfer from the PRC Commerce Bureau in accordance with the Provisional Rules on Acquisition of Domestic Company by Foreign Investors. After obtaining approval from the Commerce Bureau, Beijing HollySys would have to re-register its record ownership with the Administration of Industry & Commerce. Under the terms of the proposed transaction, Gifted Time Holdings is the consignee with the right to direct legal title to the stock in Beijing HollySys to be transferred to Chardan. Under the terms of the stock purchase, Gifted Time Holdings is obligated to direct the transfer of the Beijing HollySys stock to Chardan, and the consignor is obligated to effect the transfer, so long as it is a permitted transfer and the transferee is acceptable under PRC law. In this instance, Beijing HollySys will be changed from a joint stock company to a limited liability company, so the restriction on transfer relating to the period of time the stock is held by the record owner will no longer apply. Chardan believes that it (or, post-transaction, HLS) would be an acceptable transferee under PRC law.

The Stock Purchase Agreement requires that PRC counsel issue opinions regarding the validity and enforceability of all the consignment agreements involved in this transaction and the validity of the ultimate transfer of title to the Beijing HollySys stock to Chardan and its successors. On the basis of its discussions with counsel, the Chardan board of directors concluded that the use of stock consignment agreements, as described, are an acceptable method for obtaining a controlling interest in HollySys.

### **Stock Consignment Agreements**

The stock consignment agreements provide for the control of the shares of Beijing HollySys by Gifted Time Holdings, even though the shares are registered in the name of a different entity or person. The reason for the agreement is that the shares held by the directors, supervisors or the senior managers of a joint stock company formed under PRC law may not be transferred in amounts in excess of 25% of the person's holdings annually during the incumbency period. Dr. Wang Changli, who held 14.23% of the outstanding shares of Beijing HollySys, is subject to this restriction. Dr. Wang transferred his equity interests to Gifted Time Holdings by entering into a consignment agreement. Since the other HollySys Stockholders (other than Team Spirit and OSCAF) have entered into voting-together agreements with Dr. Wang, they also consigned their equity interests in Beijing HollySys to Gifted Time Holdings in order to act in concert with Dr. Wang, even though the other stockholders are not subject to the same transfer restrictions as Dr. Wang. Each stockholder has entered into separate consignment agreements.

The agreements give Gifted Time Holdings the control of the shares of Beijing HollySys subject thereto. The agreements give Gifted Time Holdings the right to manage in all respects the shares held in title by the stockholder, including all stockholder rights to call meetings of stockholders, to submit stockholder proposals, to elect directors, to vote the shares on all matters and to exercise all other rights of a stockholder in respect of the shares consigned. More specifically, the consignment agreements include giving the right to replace and increase the number of the directors, supervisors and recommend new director and supervisor persons, and to exercise management rights, controlling rights and decision-making power over the shares or the subject company. As consideration for the consignment of rights, Gifted Time Holdings issued shares of its common stock to the consigning parties, resulting in each consigning

party owning the percentage of Gifted Time Holdings as set forth in the table on page 19 above.

All of the Beijing HollySys shares held by each HollySys Stockholder are subject to the agreements. The agreements are subject to force majeure limitations, such that neither party will be liable to the other party for any delay or failure to perform its obligation under the agreement, if such failure or delay is due to a force majeure event. A force majeure event is an event that is outside the reasonable control of the party (e.g, fire, flood, acts of God). There is no unilateral right of termination, except in the event of a breach, in which event the non-breaching party may cancel the consignment agreement after notice and a reasonable cure period. Under the consignment agreements, if the breaching party fails to cure within the reasonable time period, the non-breaching party will be entitled to hold the breaching party liable for all damages and economic loss as a result of such breach. Because Gifted Time Holdings does not have any specific obligations under the consignment agreements, the provisions pertaining to breach of the agreement primarily aim to act as a deterrent for breach by the consignors. In the event of a default, the consignment agreements provide that the defaulting party's liability shall not exceed the amount of economic loss that the defaulting party could anticipate or should anticipate as of the date of the agreement. Each consigning stockholder has warranted its authority to enter into the agreement and that it has not entered into any other agreements that would conflict with the consignment agreement. The consignor is not left with any rights of his or her beneficial ownership of the stocks consigned other than title to record ownership.

The import of the stock consignment agreements is that Gifted Time Holdings, and subsequently HLS, may consolidate the HollySys Operating Companies whose shares are subject to stock consignment agreements in the manner of wholly and majority owned subsidiaries and enjoy the economic benefits of such subsidiaries. The stock consignment agreements are subject to enforceability and limitations of the laws and rules of PRC. PRC counsel to the HollySys Stockholders have opined that these agreements are enforceable under current PRC law. The termination of one stockholder's consignment agreement does not cause the termination of any of the other consignment agreements, so it would only result in a reduction in consigned shares under Gifted Time Holdings' control. Because the consignment agreements are entered into by the stockholders who hold in total 74.11% of the equity interests in Beijing HollySys, the stock consignment agreements are enforceable only by such stockholders of Beijing HollySys, representing 74.11% of Beijing HollySys. Under the consignment agreements, legal actions may be initiated in a "competent jurisdiction," which refers to the British Virgin Islands since British Virgin Islands law governs such agreements.

There are five consignment agreements entered into between Gifted Time Holdings and five British Virgin Island companies. The following is a table of the parties to the consignment agreements showing the percentage of shares of Beijing HollySys consigned by each party:

Consigned Stock	Consigning Owner	% of Total Shares
Beijing HollySys	Ace Lead Profits Limited (Wang Changli)	14.23%
Beijing HollySys	Plus View Investments Limited (Luo An)	9.88%
Beijing HollySys	Acclaimed Insight Investments Limited (Cheng Wusi)	24%
Beijing HollySys	Pioneer Sum Investments Limited (Mei Qinglin)	6%
Beijing HollySys	Allied Earn Investments Limited (Shanghai Jinqiaotong Industrial Development Co., Ltd.)	20%

Each consigning owner listed above is a party to a consignment agreement with Gifted Time Holdings in which all of the consigning owner's control rights to Beijing HollySys, representing the percentage of total shares set forth in the table above, were transferred to Gifted Time Holdings.

### **Protections of Shareholders Against the Loss of Consigned Assets**

The structure of the consignment agreements is intended to protect the rights and interests of Gifted Time Holdings in Beijing HollySys.

There are additional corporate protections. The board of directors of HLS will be comprised of a majority of independent persons, one of which initially will be a designee of Chardan. The board of directors will be maintained pursuant to the rules of Nasdaq which require a majority of persons on the board of directors to be independent directors and that transactions with insiders must be approved by an audit committee comprised of independent directors. The consignees will not be deemed independent persons under the rules of Nasdaq, and therefore they will not be eligible to be members of the audit committee. Moreover, HLS has a code of ethics that requires fair dealing by officers and directors in transactions with the company. Although one of the persons consigning the shares of Beijing HollySys will be an officer and director of HLS, the above corporate controls are several methods that prevent him

from taking a decision to terminate the consignment agreement unilaterally for his own benefit. Because a termination of a consignment agreement would be a material event, it would be disclosed in an 8-K report.

A termination of the consignment agreements would be a transfer of a substantial asset of HLS. Pursuant to the law of the British Virgin Islands applicable to HLS, the sale or transfer of 50% or more of the assets of the company requires approval of the shareholders. Such approval would require a meeting of the shareholders to be called and held, with a proxy statement describing the action to be approved and the consequences of the approval.

Pursuant to the Stock Purchase Agreement, each HollySys Stockholder who consigns his shares to Gifted Time Holdings will use best efforts to complete the acquisition of the ownership of the consigned stock by Gifted Time Holdings from such HollySys Stockholder as soon as such acquisition is permitted by applicable law and regulations. Once consigned stock is transferred to Gifted Time Holdings, it will no longer be subject to the consignment agreement and a termination of the consignment agreement will not affect its ownership.

In the event that the consignment agreements are cancelled sometime in the future, then HLS would lose the control of the companies to the extent that the stock had not been previously transferred to it.

### *Satisfaction of 80% Test*

It is a requirement that any business acquired by Chardan have a fair market value equal to at least 80% of its net assets at the time of acquisition, which assets shall include the amount in the trust account. Based on the financial analysis of HollySys generally used to approve the transaction, the Chardan board of directors determined that this requirement was met and exceeded.

To determine the value of HollySys, the board compiled a list of ten comparable engineering/systems automation companies whose stock is traded in the public markets. These companies were broken into three tiers based on their market capitalization to delineate their relative market presence and cycle maturity. Tier one included companies with market capitalization of over fifty billion dollars; tier two included companies with market capitalizations between ten billion and fifty billion dollars; and tier three included companies with less than ten billion of market capitalization. The board then examined the price earnings ratio to these companies. The overall average price earnings ratio for the 10 companies was 20.16. The average price earnings ratio was 19.54 for the tier two companies. The board used the 19.54 price earnings ratio of the tier two companies because it was the average and, therefore, the most representative.

The companies used for this analysis were as follows:

Name	Exchange	Price (USD)	Market Cap (MM)	Shares Outstanding (MM)	Enterprise Value (MM)	Price Earnings Ratio (P/E)
GENERAL ELECTRIC CO	NYSE	34.85	367,495.16	10,600.81	603,153.06	20.15
SIEMENS AG	XETRA	73.05	65,091.58	891.09	68,134.61	17.54
<b>Tier 1 Average</b>						<b>18.85</b>
<b>HONEYWELL INTERNATIONAL</b>						
INTERNATIONAL	NYSE	36.63	31,246.48	855.15	35,110.02	17.44
EMERSON ELECTRIC CO	NYSE	62.63	26,097.82	413.09	28,947.99	18.58
ABB LTD	VIRT-X	6.54	13,549.39	2,028.41	14,899.11	22.59
<b>Tier 2 Average</b>						<b>19.54</b>
<b>ROCKWELL AUTOMATION INC</b>						
AUTOMATION INC	NYSE	48.71	8,960.89	181.60	9,128.94	19.18
EATON CORP	NYSE	59.90	9,026.93	147.40	10,597.26	12.20
YOKOGAWA ELECTRIC	TOKYO	13.54	3,439.94	243.23	3,973.58	33.59
INVENSYS PLC	LONDON	0.19	1,069.83	5,686.36	2,856.25	NA
ECHELON CORP	NASDAQ	6.88	280.62	40.12	120.97	NA
<b>Tier 3 Average</b>						<b>21.66</b>
<b>Total Average</b>						<b>20.16</b>

The board made several assumptions in deriving statistics about HollySys, solely for the purpose of management determining a value of HollySys. Investors should not place any weight on these projections because any projection is subject to many assumptions some or all of which may not be correct or occur as assumed. The assumptions were for the projection of revenues and net income for 2006. The net income assumption for fiscal year 2006 was \$17,356,000. The projected net income for 2006 was determined reasonable in light of the net income for 2003 of approximately

\$2,227,000, for 2004 of \$4,735,000, and for 2005 of \$13,703,000 and orders for sales. Deductions were taken for the costs of the acquisition, increased business operations expense and additional general and administrative expenses, notably those associated with being a public company. The 2006 projection was also derived using a 17% margin. It was also assumed that HollySys' long-term debt would not increase would therefore have static debt of approximately \$6,800,000. Existing cash was assigned a re-investment growth rate of the current LT Treasury Yield while debt service was assigned a rate of twice the current LT Treasury Yield when computing applicable interest income (expense). The current LT Treasury Yield was set at 3.81%

The board used 30,500,00 as the number of shares outstanding immediately after the transaction while the fully diluted calculations included the additional shares issuable by the exercise of outstanding warrants.

The enterprise value is derived by the following formula: Enterprise Value equals Market Capitalization, plus Debt, plus Preferred Equity, minus Cash and Cash Equivalents. Using this formula, the board of directors arrived at a projected enterprise value for HollySys of \$337,367,000 for 2006. This was derived using a market capitalization of \$339,095,000, an amount determined by taking the fair market comparable capitalization using an implied market capitalization equal to a comparable price earnings ratio of 19.54 multiplied by the assumed earnings of HollySys for 2006 of \$17,356,000. There is anticipated to be no additional debt in 2006 beyond the current \$6,800,000 and no preferred equity issued and outstanding in HollySys. Cash and cash equivalents of HollySys for 2006 were assumed to be \$8,524,000, which funds will be derived from their operations.

The Chardan board of directors believes because of the financial skills and background of several of its members, it was qualified to make this analysis itself and conclude that the acquisition of the HollySys Operating Companies met this requirement without recourse to an independent source.

### ***Conclusion of the Board of Directors***

After careful consideration, Chardan's board of directors determined unanimously that each of the stock purchase proposal, the Redomestication Merger proposal and the stock option proposal is fair to and in the best interests of Chardan and its stockholders. Chardan's board of directors has approved and declared advisable the stock purchase proposal, the Redomestication Merger proposal and the stock option proposal and unanimously recommends that you vote or give instructions to vote "FOR" each of the proposals to adopt the stock purchase proposal, the Redomestication Merger proposal, the stock option proposal and the election of directors.

The foregoing discussion of the information and factors considered by the Chardan board of directors is not meant to be exhaustive, but includes the material information and factors considered by the Chardan board of directors.

### ***Material U.S. Federal Income Tax Considerations of the Redomestication Merger***

The following discussion summarizes the material United States federal income tax consequences of the Redomestication Merger to the Chardan stockholders who are "United States persons," as defined for United States federal income tax purposes and who hold their Chardan common stock as a capital asset within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the "Code"). This discussion, insofar as it relates to matters of United States federal tax law and regulations or legal conclusions with respect thereto, constitutes the opinion of DLA Piper Rudnick Gray Cary US LLP as to the material federal income tax consequences of the Redomestication Merger to Chardan and its stockholders. For United States federal income tax purposes, a "United States person" is:

- a citizen or resident of the United States;
- a corporation, partnership, or other entity created or organized in the United States or under the laws of the United States or any state within the United States;
- an estate whose income is includible in gross income for U.S. federal income tax purposes, regardless of its source; or
- a trust whose administration is subject to the primary supervision of a U.S. court and that has one or more U.S. persons who have the authority to control all substantial decisions of the trust.

The term “non-United States person” means a person or holder other than a “United States person.”

This section does not discuss all of the United States federal income tax considerations that may be relevant to a particular stockholder in light of his or her individual circumstances or to stockholders subject to special treatment under the federal income tax laws, including, without limitation:

- brokers or dealers in securities or foreign currencies;
- stockholders who are subject to the alternative minimum tax provisions of the Code;
- tax-exempt organizations;
- stockholders who are “non-United States persons”;
- expatriates;
- stockholders that have a functional currency other than the United States dollar;
- banks, mutual funds, financial institutions or insurance companies;
- stockholders who acquired Chardan common stock in connection with stock option or stock purchase plans or in other compensatory transactions; or
- stockholders who hold Chardan common stock as part of an integrated investment, including a straddle, hedge, or other risk reduction strategy, or as part of a conversion transaction or constructive sale.

No ruling has been or will be sought from the Internal Revenue Service as to the United States federal income tax consequences of the Redomestication Merger, and the following summary is not binding on the Internal Revenue Service or the courts. This discussion is based upon the Code, regulations, judicial authority, rulings and decisions in effect as of the date of this Registration Statement, all of which are subject to change, possibly with retroactive effect. This summary does not address the tax consequences of the Redomestication Merger under state, local and foreign laws or under United States federal tax law other than income tax law.

Subject to the limitations and qualifications referred to herein and assuming that the Redomestication Merger will be completed as described in the merger agreement and this Registration Statement, the Redomestication Merger will constitute a “reorganization” within the meaning of Section 368(a) of the Code, and the following United States federal income tax consequences will result:

- Chardan stockholders will not recognize any gain or loss upon the receipt of HLS common stock in exchange for Chardan common stock in connection with the Redomestication Merger;
- the aggregate tax basis of the HLS common stock received by a Chardan stockholder in connection with the Redomestication Merger will be the same as the aggregate tax basis of the Chardan common stock surrendered in exchange for HLS common stock;
- the holding period of the HLS common stock received by a Chardan stockholder in connection with the Redomestication Merger will include the holding period of the Chardan common stock surrendered in connection with the Redomestication Merger; and
- Chardan will recognize gain, but not loss, as a result of the Redomestication Merger equal to the difference, if any, between the adjusted tax basis in Chardan’s assets and such asset’s fair market value at the effective time of the Redomestication Merger.

The foregoing United States federal income tax consequences is not affected by the changes made to the Code by the American Jobs Creation Act of 2004 in the treatment of domestic business entities which expatriate from the United States to a foreign jurisdiction. These new provisions, under Section 7874 of the Code, generally apply to the direct or indirect acquisition of substantially all of the properties of a domestic enterprise by a foreign corporation if there is at least 60% or 80% of continuing share ownership in the successor foreign entity by the former U.S. corporation's stockholders and substantial business activities are not conducted in the jurisdiction in which such successor is created or organized. Under the Chardan Redomestication Merger and the Stock Purchase Agreement, following the Redomestication Merger into HLS, more than 60% of stock of HLS (by vote and by value) will be held by persons who were not holders of Chardan common stock, and accordingly Section 7874 should not apply to HLS.

**BECAUSE OF THE COMPLEXITY OF THE TAX LAWS, AND BECAUSE THE TAX CONSEQUENCES TO ANY PARTICULAR STOCKHOLDER MAY BE AFFECTED BY MATTERS NOT DISCUSSED ABOVE, EACH STOCKHOLDER IS URGED TO CONSULT A TAX ADVISOR WITH RESPECT TO THE SPECIFIC TAX CONSEQUENCES OF THE TRANSACTIONS CONTEMPLATED BY THE REDOMESTICATION MERGER AND THE STOCK PURCHASE TO HIM, HER OR IT, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL AND NON-U.S. TAX LAWS, AS WELL AS U.S. FEDERAL TAX LAWS.**

#### *Anticipated Accounting Treatment*

The stock purchase transaction will result in the current shareholders of Gifted Time Holdings obtaining a majority of the voting interests in Chardan Sub (subsequently named HLS Systems International Limited). Generally accepted accounting principles require that the company whose shareholders retain the majority voting interest in a combined business be treated as the acquirer for accounting purposes. Since Chardan does not have any assets with operating substance except cash and short-term investments, the transaction has been accounted for as reorganization and recapitalization of Gifted Time Holdings. The cash of \$30 million to be paid to the shareholders of Gifted Time Holdings will be accounted for as a capital distribution. The stock purchase transaction utilizes the capital structure of Chardan and the assets and liabilities of Gifted Time Holdings are recorded at historical cost. Although Gifted Time Holdings will be deemed to be the acquiring company for accounting and financial reporting purposes, the legal status of Chardan Sub (subsequently named HLS Systems International Limited) as the surviving corporation will not change.

#### **Regulatory Matters**

The stock purchase and the transactions contemplated by the Stock Purchase Agreement are not subject to the HSR Act or any federal or state regulatory requirement or approval in the United States or British Virgin Islands, except for filings necessary to effectuate the transactions contemplated by the stock purchase proposal with the State of Delaware and the British Virgin Islands. The stock transfer agreements between Gifted Time Holdings and Team Spirit Industrial Ltd. and OSCAF International Co. Ltd. required approval by the applicable Chinese governmental authorities under PRC law. Hangzhou HollySys received approval of the stock transfer agreements from the Commerce Bureau on February 13, 2006. In addition, in accordance with Notice 75, Notice on Issues concerning Foreign Exchange Management in PRC Residents' Financing and Return investments through Overseas Special Intention Company, promulgated by the Chinese State Administration for Foreign Exchange ("SAFE"), the HollySys Stockholders are required to apply for Foreign Exchange Investment Registration before setting up their respective British Virgin Islands companies and acquiring any equity interest in Gifted Time Holdings. The HollySys Stockholders filed all the necessary documents with SAFE in March 2006, and SAFE has accepted the submission. A more detailed discussion of the Notice 75 requirements promulgated by SAFE are in the "Risk Factors" section on page 37. Aside from the requirements and approvals discussed above, the stock purchase and the transactions contemplated by the Stock Purchase Agreement are not subject to any other foreign regulatory requirements or approvals.

## THE STOCK PURCHASE AGREEMENT

The following summary of the material provisions of the Stock Purchase Agreement is qualified by reference to the complete text of the Stock Purchase Agreement, a copy of which is attached as an annex to this proxy statement/prospectus, and is incorporated by reference. All stockholders are encouraged to read the Stock Purchase Agreement in its entirety for a more complete description of the terms and conditions of the stock purchase.

### Structure of the Stock Purchase and Redomestication Merger

At the effective time of the Stock Purchase Agreement, Chardan will be merged with and into HLS Systems International Ltd. (“HLS”). HLS will continue as the surviving company. All of the stock of Chardan will be converted into the right to receive stock in HLS on a one-for-one basis. HLS will purchase all the common stock of Gifted Time Holdings, a British Virgin Island corporation, for \$30,000,000 and 23,500,000 shares of common stock, and the additional consideration described below. Through its acquisition of Gifted Time Holdings and the stock consignment agreements, HLS will obtain the ownership or rights to control approximately 74.11% of the stock of Beijing HollySys and 89.64% of the stock of Hangzhou HollySys (including beneficial ownership of 29.64% of the stock of Hangzhou HollySys as a result of Beijing HollySys owning 40% of Hangzhou HollySys). Because the Stock Purchase Agreement is entered into by and between the stockholders of Gifted Time Holdings and Chardan, the agreement is enforceable by the stockholders of Gifted Time Holdings and will be enforceable by the stockholders of HLS after the completion of the Redomestication Merger.

### Closing and Effective Time of the Stock Purchase

The closing of the stock purchase will take place promptly following the satisfaction of the conditions described below under “Conditions to the Completion of the Acquisition,” unless Chardan and the HollySys Stockholders agree in writing to another time.

### Name; Headquarters; Stock Symbol

After completion of the stock purchase:

- the name of the combined company will be HLS Systems International Ltd.
- the corporate headquarters and principal executive officers will be located at 19 Jiancaicheng Middle Road, Xisanqi, Haidan District, Beijing, China 100096, which is currently the HollySys corporate headquarters; and
- the combined company will cause the common stock, warrants and units outstanding prior to the stock purchase, which are traded on the OTC Bulletin Board, to continue trading on either the OTC Bulletin Board or the Nasdaq Stock Market. HLS intends to apply for listing using the symbols HLSS for the common stock, HLSSW for the warrants and HLSSU for the units.

### Purchase Price

The HollySys Stockholders (or the parties to which they have assigned their rights) will be paid an aggregate of \$30,000,000 in cash and will receive an aggregate of 23,500,000 shares of HLS common stock for all the outstanding common stock of Gifted Time Holdings. A portion of the cash purchase price (\$3,000,000 plus two-thirds of the amount by which the funds in the trust account following exercise of any conversion rights is less than \$30,000,000) will be deferred until HLS receives at least \$60,000,000 in subsequent financing or HLS generates positive after-tax cash flow equal to twice the deferred amount. The initial cash payment will be made with funds in the trust account. The balance of the funds in the trust account will be used for operational expenses.

As additional consideration, certain HollySys Stockholders (or the parties to which they have assigned their rights) will be issued an aggregate of up to 8,000,000 shares of common stock of HLS for each of the next four years (2,000,000 shares per year on a all-or-none basis), if on a consolidated basis, HLS generates after-tax profits (excluding after-tax operating profits from any subsequent acquisition for securities that have a dilutive effect and any expenses derived from the issuance of aforementioned shares by HLS) of at least the following amounts:

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Year ending June 30,	After Tax Profit
2007	\$ 23,000,000
2008	\$ 32,000,000
2009	\$ 43,000,000
2010	\$ 61,000,000

## Representations and Warranties

The Stock Purchase Agreement contains a number of generally reciprocal representations and warranties that the HollySys Stockholders and Chardan made to each other. These representations and warranties relate, as applicable, to:

- organization, standing, power;
- capital structure;
- authorization, execution, delivery, enforceability of the Stock Purchase Agreement;
- absence of conflicts or violations under organizational documents, certain agreements and applicable laws or decrees, as a result of the contemplated transaction, and receipt of all required consents and approvals;
- absence of certain changes or events since September 30, 2005;
- litigation;
- compliance with applicable laws;
- absence of brokers;
- absence of undisclosed liabilities;
- accuracy of information contained in the financial statements; and
- completeness and truthfulness of the information and provisions in the Stock Purchase Agreement.

The HollySys Stockholders also make representations to Chardan relating to the HollySys Operating Companies regarding:

- ownership of the subsidiary stock;
- labor relations and employee plans;
- environmental liability;
- taxes, tax returns and audits;
- licenses and permits;
- the absence of illegal or improper transactions;

- the collectibility of accounts receivable;
- the nature and condition of inventory;
- the contracts to which they are parties;

- intellectual property rights;
- non-real estate leases;
- insurance;
- the accuracy and completeness of books and records;
- related party transactions; and
- affiliates of Beijing HollySys.

The HollySys Stockholders also make representations to Chardan regarding:

- their acquisition of HLS common stock being solely for their own account;
- their status as accredited investors;
- the adequacy of the information they received regarding Chardan;
- the restricted nature of the securities that they will receive under the Stock Purchase Agreement; and
- the placement of legends on the certificates representing the securities issued to them under the Stock Purchase Agreement.

Chardan also makes representations to the HollySys Stockholders regarding:

- filings with the SEC and the accuracy and completeness of the information contained in those filings, including the financial statements and the lack of undisclosed liabilities; and
- the amount of funds contained in the trust account.

### **Materiality and Material Adverse Effect**

Many of the representations and warranties made by the HollySys Stockholders are qualified by materiality or the use of the term “material adverse effect.” For the purposes of the Stock Purchase Agreement, a “material adverse effect” means a material adverse effect on the business, assets, operations, financial condition, liquidity or prospects of HollySys or the HollySys Operating Companies.

Several of the representations and warranties made by Chardan are qualified by materiality. However, only Chardan’s representation and warranty related to the absence of certain changes and the absence of litigation is qualified by the use of the term “material adverse effect.”

### **Interim Operations of Chardan and HollySys**

*Interim Covenants relating to the HollySys Operating Companies and the HollySys Stockholders.* Under the Stock Purchase Agreement, each of the HollySys Stockholders has agreed to use their best efforts to cause the HollySys Operating Companies to conduct business in the usual, regular and ordinary course, in substantially the same manner as previously conducted. In addition to this agreement regarding the conduct of business generally, subject to specified exceptions, the HollySys Stockholders have agreed that, except as otherwise expressly permitted or required

by the Stock Purchase Agreement, they will, and they will use their best efforts to cause the HollySys Operating Companies to:

·not declare, set aside or pay any dividends on, or make any other distributions in respect of, any of their capital stock;

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- not pledge, sell, transfer, dispose or otherwise encumber or grant any rights or interests to any others in the HollySys stock or the HollySys Operating Companies stock;
- not pledge, sell, transfer, lease dispose of or otherwise encumber any property or assets of any HollySys Operating Company, other than in accordance with past practice or in the normal course of business;
- not issue, deliver, sell or grant any shares of its capital stock, any securities convertible into or exchangeable for, or any options, warrants or rights to acquire, any shares of capital stock;
- not make or agree to a general wage or salary increase or enter into any employment contract, increase the compensation payable or to become payable to any officer or employee of any HollySys Operating Company or adopt or increase the benefits of any bonus, insurance, pension or other employee benefit plan, payment or arrangement, except for those increases consistent with past practices, normally occurring as the result of regularly scheduled salary reviews and increases, and except for increases directly or indirectly required as a result of changes in applicable laws;
- not amend the organization documents of the HollySys Operating Companies;
- not merge or consolidate with, or acquire all or substantially all the assets of, or otherwise acquire, any other business operations;
- not make any payments outside the ordinary course of business;
- not make any capital expenditures, except in accordance with prudent business and operational practices consistent with prior practice;
- provide Chardan with access to information regarding the business of HollySys and the HollySys Operating Companies;
- maintain in effect insurance of the types and in the amounts customarily acquired to protect the assets and business of the HollySys Operating Companies;
- protect the confidential information of the HollySys Operating Companies that they have received in the course of the negotiations;
- refrain from competing with HollySys or the HollySys Operating Companies;
- refrain from any discussions or negotiations with any other party regarding the issuance of any capital stock or the sale or transfer of any portion of the business of any HollySys Operating Company;
- refrain from engaging in any transaction involving the securities of Chardan;
- disclose certain material information that arises or comes to be known between the date of the Stock Purchase Agreement and the date of the closing;
- use their best efforts to obtain all authorizations, consents, orders and approvals that may be or become necessary for their execution and delivery of, and the performance of their obligations pursuant to, the Stock Purchase Agreement;
- not acquire any rights to or use any of the intellectual property of HollySys or the HollySys Operating Companies;

- pay any taxes that become due as a result of the issuance to them of HLS common stock;
- do all things necessary to effectuate the HollySys stock purchase transaction contemplated under the Stock Purchase Agreement;

- complete the restructuring related to the formation and ownership of Gifted Time Holdings and have Gifted Time Holdings obtain any required stockholder approval for the stock purchase transaction contemplated under the Stock Purchase Agreement;
- provide to Chardan such information as is necessary regarding Gifted Time Holdings and the HollySys Operating Companies as is required under the rules of the SEC for the proxy statements; and
- provide to Chardan interim internal financial and management reports regarding the conduct of the business of the HollySys Operating Companies.

*Interim Covenants relating to Chardan.* The Stock Purchase Agreement, among other things, requires Chardan to:

- conduct its business in the ordinary course, not sell or issue any capital securities of Chardan, encumber any of the assets of Chardan or incur any debt out of the ordinary course, not declare or pay any dividend, or make any general wage increase;
- not change its Certificate of Incorporation, by-laws, articles or other organizational documents;
- call the stockholders meeting to which this proxy relates;
- incorporate HLS;
- cause the board of HLS, after the closing, to initially consist of seven persons, of which two members will be designated by the HollySys Stockholders, one member will be designated by the board of Chardan and four members will satisfy the independence requirements of Nasdaq; and
- apply to have the shares of HLS listed in the Nasdaq National Market following the closing.

#### **No Solicitation by Chardan**

Except as described below, generally Chardan will not:

- solicit, initiate or encourage the submission of any acquisition proposal;
- enter into any agreement with respect to any acquisition proposal; or
- participate in any discussions or negotiations regarding, or furnish to any person any information with respect to, or take any other action to facilitate any inquiries or the making of any proposal that constitutes, or may reasonably be expected to lead to, any acquisition proposal.

However, Delaware corporate law requires, if Chardan receives a bona fide written acquisition proposal which was not solicited by Chardan, it may, before the Stock Purchase Agreement is adopted by its stockholders, furnish information regarding itself to the person making the acquisition proposal and participate in discussions, but not negotiations, with the person regarding the acquisition proposal, if:

- the board of directors determines, in good faith that the acquisition proposal constitutes or is reasonably likely to lead to a superior proposal; and

·the board of directors determines in good faith that failure to submit such superior proposal to its stockholders would cause the board of directors to violate its fiduciary duties to the stockholders under applicable law.

If Chardan has received a superior proposal, Chardan has the right to terminate the Stock Purchase Agreement, based upon a determination in good faith, relying upon the advice of outside legal counsel, that the failure to terminate is reasonably likely to result in the board of directors breaching its fiduciary duty.

### **No Solicitation by the HollySys Stockholders**

The HollySys Stockholders have agreed that they will not, and will use their best efforts to cause the HollySys Operating Companies to not:

- solicit, initiate or encourage discussions regarding or the submission of any acquisition proposal;
- enter into any agreement with respect to any acquisition proposal; or
- participate in any discussions or negotiations regarding, or furnish to any person any information with respect to, or take any other action to facilitate any inquiries or the making of any proposal that constitutes, or may reasonably be expected to lead to, any acquisition proposal.

The HollySys Stockholders will cease immediately all discussions and negotiations regarding any proposal that constitutes, or may reasonably be expected to lead to, an acquisition proposal.

### **Chardan Stockholders' Meeting**

Chardan has agreed to call and hold a meeting of its stockholders, as soon as practicable after the date of the Stock Purchase Agreement for the purpose of seeking the approval of the stock purchase by its stockholders. Chardan has also agreed that it will file all required proxy materials with the SEC and, through its board of directors, recommend to its stockholders that they approve and adopt the stock purchase proposal.

### **Access to Information; Confidentiality**

Chardan and HollySys will afford to the other party and its representatives prior to completion of the stock purchase reasonable access during normal business hours to all of their respective properties and records and will promptly provide to the other party a copy of each document filed pursuant to the requirements of the securities laws the United States, and all other information concerning its business, properties and personnel as the other party reasonably requests. The information will be held in confidence to the extent required by the provisions of the confidentiality agreement between the two parties.

### **Reasonable Efforts; Notification**

Chardan and the HollySys Stockholders have agreed that they will use all reasonable efforts to take all actions, and to do all things necessary, proper or advisable to consummate the stock purchase and the transactions contemplated by the Stock Purchase Agreement in the most expeditious manner practicable. This includes:

- obtaining all necessary actions or non-actions, waivers, consents and approvals from governmental entities and making all necessary registrations and filings, including filings with governmental entities, if any, and taking all reasonable steps as may be necessary to obtain an approval or waiver from, or to avoid an action or proceeding by, any governmental entity;
- obtaining all necessary consents, approvals or waivers from third parties;
- defending any lawsuits or other legal proceedings, whether judicial or administrative, challenging the Stock Purchase Agreement or any other agreement contemplated by the Stock Purchase Agreement or the consummation of the stock purchase or other transactions contemplated by the Stock Purchase Agreement including seeking to have any stay or temporary restraining order entered by any court or other governmental entity vacated or reversed; and

·executing and delivering any additional instruments necessary to consummate the stock purchase or other transactions contemplated by the Stock Purchase Agreement and to fully carry out the purposes of the Stock Purchase Agreement and the transaction agreements contemplated by the Stock Purchase Agreement.

The HollySys Stockholders will give prompt notice to Chardan, and Chardan will give prompt notice to the HollySys Stockholders, of:

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- any representation or warranty made by it contained in the Stock Purchase Agreement becoming inaccurate or misleading; or
- the failure by it to comply with or satisfy in any material respect any covenant, condition or agreement to be complied with or satisfied by it under the Stock Purchase Agreement.

However, no notification will affect the representations, warranties, covenants or agreements of the parties or the conditions to the obligations of the parties under the Stock Purchase Agreement or the agreements contemplated thereby as originally made. Accordingly, such notification may permit a termination of the Stock Purchase Agreement.

### **Indemnification**

The HollySys Stockholders shall indemnify and hold harmless Chardan (or HLS after the closing) for any damages, whether as a result of any third party claim or otherwise, which arise from or in connection with the breach of representations and warranties and agreements and covenants of the HollySys Stockholders. Chardan shall indemnify and hold harmless each HollySys Stockholder for any damages, whether as a result of any third party claim or otherwise, which arise from or in connection with the breach of representations and warranties and agreements and covenants of Chardan, which will be assumed by HLS upon the Redomestication Merger. Claims may be asserted once the damages exceed \$250,000. Any indemnification payments shall be deemed to be an adjustment to the purchase price.

The determination to assert a claim for indemnification against the HollySys Stockholders for the benefit of Chardan (or HLS after the closing) will be determined by an independent committee of the board of directors of Chardan. The independent committee of the board of directors will consist of at least two persons, as selected by the board of directors, none of whom is an officer or employee of Chardan (or HLS after the closing) and its subsidiaries or is the direct or beneficial owner of 5% or more of the voting capital stock of Chardan (or HLS after the closing).

### **Expenses**

Except as provided in the Stock Purchase Agreement, all fees and expenses incurred in connection with the stock purchase and the other transactions contemplated by the Stock Purchase Agreement will be paid by the party incurring such expenses, whether or not the stock purchase is consummated. The HollySys Stockholders have agreed they have no right to claim or be paid any amount from the Chardan trust account, except on consummation of the Stock Purchase Agreement.

### **Public Announcements**

Chardan, on the one hand, and the HollySys Stockholders, on the other hand, have agreed:

- to consult with each other before issuing, and provide each other the opportunity to review and comment upon, any press release or other public statements with respect to the stock purchase and the other transactions contemplated by the Stock Purchase Agreement; and
- not to issue any press release or make any public statement prior to this consultation, except as may be required by applicable laws or court process.

### **Conditions to the Completion of the Acquisition**

Consummation of the stock purchase is conditioned on the stockholders of Chardan, at a meeting called for these purposes, (i) approving the Stock Purchase Agreement and related transactions, and (ii) approving the merger of Chardan into HLS for the purpose of corporate reincorporation and redomestication in the British Virgin Islands, which will include retention of the HLS name and an increase in the authorized capital of the current company. The stockholders will also be asked to adopt a stock plan, but the stock purchase and redomestication transactions are not dependent on the approval of this plan.

In addition, the Stock Purchase Agreement is conditioned upon (i) no order, stay, judgment or decree issued by any governmental authority preventing, restraining or prohibiting in whole or in part, the consummation of the transactions contemplated in the Stock Purchase Agreement, (ii) execution and delivery to each party of each of the various transaction documents, (iii) delivery by each party to the other party of a certificate to the effect that the representations and warranties of each party are true and correct in all material respects as of the closing and all covenants contained in the Stock Purchase Agreement have been materially complied with by each party, and (iv) receipt of necessary consents and approvals by third parties and completing necessary proceedings.

The obligations of each HollySys Stockholder to consummate the transactions contemplated by the Stock Purchase Agreement also are conditioned upon each of the following, among other things:

- HLS will have delivered the HLS stock and made the payments specified in the Stock Purchase Agreement, and the HollySys Stockholders will have received confirmations of the payment of the cash portion thereof and such other documents, certificates and instruments as may be reasonably requested by the HollySys Stockholders;
- the HollySys Stockholders must have received a legal opinion, dated as of the closing, from DLA Piper Rudnick Gray Cary US LLP, counsel to Chardan;
- HLS will be an existing company under the laws of the British Virgin Islands;
- Gifted Time Holdings shall have entered into, effective as of the closing, the employment agreements with the key executives, Dr. Wang Changli and Madame Qiao Li, the forms of which are exhibits to the Stock Purchase Agreement;
- Chardan must have performed all its obligations and all of Chardan's representations and warranties must be true and correct;
- at the closing, there will have been no material adverse change in the assets, liabilities or financial condition of Chardan and HLS from that shown in the Chardan balance sheet and related statements of income, and between the date of the Stock Purchase Agreement and the closing date, there will have not occurred an event which, in the reasonable opinion of HollySys, would have had a material adverse effect on the operations, financial condition or prospects of Chardan and HLS;
- effective as of the closing, the directors of Chardan who are not continuing as directors and officers of Chardan (or HLS, as the case may be) will have resigned and agreed that they have no claim for employment compensation in any form from Chardan; and
- disbursement of funds held in the trust account maintained for Chardan.

The obligation of Chardan to consummate the transactions contemplated by the Stock Purchase Agreement also are conditioned upon each of the following, among other things:

- the HollySys Stockholders will have delivered the Gifted Time Holdings stock;
- the stock consignment agreements will have been executed and delivered;
- at the closing, there will have been no material adverse change in the assets, liabilities, financial condition or prospects of Gifted Time Holdings, the HollySys Operating Companies or its business from that shown or reflected in the financial statements of September 30, 2005 and as to be described in the Chardan proxy statement, and between the date of the Stock Purchase Agreement and the closing date, there shall not have occurred an event which, in the reasonable opinion of Chardan would have a material adverse effect on Gifted Time Holdings or the HollySys Operating Companies;
- the information about Gifted Time Holdings, the HollySys Operating Companies and their subsidiaries and management provided for inclusion in the Chardan proxy statement at the time of its distribution and at the closing, will accurately reflect the business, Gifted Time Holdings, the HollySys Operating Companies and the HollySys Stockholders, and not contain any untrue statement of a material fact or omission;

- Chardan must have received a legal opinion, dated as of the closing, from Guantao Law Firm, counsel to the HollySys Stockholders, regarding the validity and enforceability of the stock consignment agreements;

- Gifted Time Holdings, the HollySys Operating Companies and each HollySys Stockholder must have performed all their obligations and all of their representations and warranties must be true and correct; and
- each of Dr. Wang Changli and Madame Qiao Li will have entered into the form of employment agreement which is an exhibit to the Stock Purchase Agreement.

### **Termination**

The Stock Purchase Agreement may be terminated at any time, but not later than the closing as follows:

- by mutual written consent of Chardan and the HollySys Stockholders;
- by either party if the other party amends a schedule and such amendment or supplement reflects a material adverse change in the condition, operations or prospects of its business;
- by either party if the closing has not occurred by December 31, 2006 (unless such terminating party is in breach of any of its material covenants, representations or warranties);
- by either party if the other party has breached any of its covenants or representations and warranties in any material respect and has not cured its breach within 10 business days of the notice of an intent to terminate, provided that the terminating party is itself not in breach;
- by Chardan if its board of directors shall have determined in good faith, based upon the advice of outside legal counsel, that failure to terminate the Stock Purchase Agreement is reasonably likely to result in the board of directors breaching its fiduciary duties to stockholders by reason of a pending, unsolicited, bona fide written proposal for a superior transaction; or
- by either party if, at the Chardan stockholder meeting, the Stock Purchase Agreement and Redomestication Merger and the transactions contemplated thereby shall fail to be approved and adopted by the affirmative vote of the holders of Chardan's common stock, or 20% or more of the shares sold in the initial public offering are presented for conversion into the pro rata portion of the trust account in accordance with the Chardan certificate of incorporation.

Neither HollySys, the HollySys Operating Companies nor the HollySys Stockholders have any right to damages from Chardan or HLS, and they have no right to any amount held in the trust account, and they have agreed not to make any claim against Chardan and HLS that would adversely affect the business, operations or prospects of Chardan and HLS or the amount of the funds held in the trust account.

### **Effect of Termination**

In the event of proper termination by either Chardan or the HollySys Stockholders, the Stock Purchase Agreement will become void and have no effect, without any liability or obligation on the part of Chardan or the HollySys Stockholders, except in connection with the confidentiality obligations set forth in the Stock Purchase Agreement.

### **Amendment**

The Stock Purchase Agreement may be amended at any time before or after receipt of the approval from Chardan's stockholders. However, after receipt of the approval from Chardan's stockholders, the parties may not, without further stockholders' approval, amend the Stock Purchase Agreement, in a manner that by law requires further approval by the stockholders of Chardan. In addition, no amendment will be binding on any of the parties unless such amendment made in writing by all of them.

Chardan and the HollySys Stockholders have entered into two amendments to the Stock Purchase Agreement. The First Amendment to the Stock Purchase Agreement, dated March 25, 2006 (i) revised the preamble to the Stock Purchase Agreement and (ii) revised the Stock Purchase Agreement to state that the employment agreements for Dr. Wang and Madam Qiao will be entered into with Gifted Time Holdings instead of with Beijing HollySys. The Second Amendment to the Stock Purchase Agreement, dated June 5, 2006, (a) changed the number of the board of directors from nine to seven and (b) extended the termination date to December 31, 2006. Both amendments to the Stock Purchase Agreement are included in Annex A to this proxy statement/prospectus.

### **Extension; Waiver**

At any time prior to the consummation of the stock purchase, Chardan and the HollySys Stockholders may extend the time for the performance of any of the obligations or other acts, waive any inaccuracies in the representations and warranties or waive compliance with any of the conditions. Such extension of time or waiver may be agreed to by Chardan even after the meeting of stockholders to approve the transaction if Chardan's board of directors determines the matter not to have a material effect on the value of the transaction for Chardan's stockholders and that it is in the best interest of Chardan and its stockholders to do so. However, we anticipate that the transaction will close promptly (within a week) after stockholder approval of the transaction, and we do not anticipate that at the time of the stockholder vote any material condition to performance of the agreement will remain unfulfilled. In the event that any material condition is unfulfilled or an inaccuracy in the representations and warranties of the HollySys Stockholders is identified after the effective date of this registration statement, we would file a post-effective amendment of this Form S-4 and would provide the content of that amendment to our stockholders as of the record date in the manner prescribed by Commission rules prior to conducting the stockholder meeting, if necessary adjourning or postponing the stockholder meeting in order to do so.

### **Employment Agreements**

Each of Dr. Wang Changli and Madame Qiao Li will enter into a three-year employment agreement with Gifted Time Holdings. Dr. Wang will be employed as the chief executive officer, and Madame Qiao will be the chairperson. Each of the agreements provide for an annual salary of \$120,000 and a discretionary cash bonus that can be up to 250% of the annual salary, as the compensation committee determines. The executives will be entitled to insurance benefits, five weeks vacation, a car and reimbursement of business expenses and, if necessary, relocation expenses. The agreements will be terminable by HollySys for death, disability and cause. The executive may terminate for good reason, which includes HollySys' breach, the executive's not being a member of the board of directors, and change of control. The agreements contain provisions for the protection of confidential information and a three-year-after employment non-competition period within China.

### **Officers of the Combined Company**

After the consummation of the stock purchase, the board of directors will appoint the following executive officers:

- Dr. Wang Changli as the chief executive officer, and
- Madame Qiao Li as the chairperson.

## **CHARDAN REDOMESTICATION MERGER**

### **General**

Chardan is reincorporating in the British Virgin Islands and in that process changing its name and corporate documents and establishing a new board of directors. The Redomestication Merger is an obligation under the Stock Purchase Agreement with the HollySys Stockholders.

We believe that the reincorporation in the British Virgin Islands (BVI) will give the continuing company more flexibility and simplicity in various corporate transactions. We also believe that being reincorporated in the BVI will facilitate and reduce the costs of any further reorganization of the HollySys Operating Companies and permit the creation and acquisition of additional companies in China as the business of HollySys expands. We believe that the reincorporation will reduce taxes and other costs of doing business by HLS in the future because its operations will be in China after the acquisition. The BVI has adopted an International Business Companies Act that allows for flexible and creative corporate structures for international businesses. Further, BVI international business companies are wholly exempt from BVI tax on their income. As part of the reincorporation, Chardan's corporate name will be that of the surviving company, "HLS Systems International, Ltd."

Reincorporation in the BVI will entail some risks for Chardan stockholders. Upon completion of the stock purchase transaction, holders of Chardan stock will represent a minority of the outstanding shares of HLS. There is little statutory law for the protection of minority shareholders under the laws of the British Virgin Islands. Similarly, the fiduciary obligations of the HLS directors under British Virgin Islands law are not as clearly established as they would be under the statutes or judicial precedent in some jurisdictions in the United States, and British Virgin Islands companies may not have standing to initiate a shareholder derivative action in a federal court of the United States. These risks are discussed in greater detail in the "Risk Factors" section under the heading "Risks Related to the Ownership of Our Stock."

The full texts of the Plan of Merger and the Memorandum and Articles of Association of HLS are set forth in annexes to this proxy statement/prospectus. The discussion of these documents and the comparison of rights set forth below are qualified in their entirety by reference to those annexes.

### **Adoption of the Redomestication Merger**

The board of directors has approved the reincorporation plan and Redomestication Merger and recommends that the stockholders of Chardan approve it.

The affirmative vote of the holders of a majority of the shares outstanding of Chardan is required for approval of the reincorporation plan and Redomestication Merger. Abstentions and broker non-votes will have the effect of a vote against the proposal.

The reincorporation plan will not be implemented if the Stock Purchase Agreement is not approved or the stock purchase is not consummated. The stock purchase will not be consummated if Chardan does not reincorporate in the BVI.

The board of directors unanimously recommends a vote "FOR" the approval of the reincorporation plan and Redomestication Merger.

### **Plan of Reincorporation and Redomestication Merger**

The reincorporation will be achieved by the merger of Chardan, a Delaware company, with and into HLS, a BVI corporation, which is wholly owned by Chardan at this time, with HLS being the surviving entity. The Memorandum of Association and the Articles of Association, the equivalent of a certificate of incorporation and bylaws of a United States company, of the surviving company will be those of HLS, written in compliance with BVI law. The effectiveness of the reincorporation and the merger is conditioned upon the filing by both Chardan and HLS of a certificate of merger with the State of Delaware and articles of merger with the BVI. Upon the filing of these documents, Chardan will cease its corporate existence in the State of Delaware.

At the time of the Redomestication Merger, one new share of HLS will be issued for each outstanding share of common stock of Chardan held by our stockholders on the effective date for the reincorporation. Each share of HLS that is owned by Chardan will be canceled and resume the status of authorized and unissued HLS common stock. The Chardan shares no longer will be eligible to trade on the over-the-counter bulletin board market. The shares of HLS will be eligible to trade in their place beginning on or about the effective date of the reincorporation under a new CUSIP number and trading symbol. The symbol will be assigned if the market will be the OTCBB or will be as determined with the approval of Nasdaq if that is where the shares will trade upon consummation of the stock purchase.

Your percentage ownership of Chardan will not be affected by the reincorporation. As part of the stock purchase transaction, however, there will be the issuance of additional shares of common stock as partial consideration for the HollySys Companies. As part of the reincorporation, HLS will assume the outstanding warrants of Chardan on the same terms as currently issued. In addition, HLS will assume all other outstanding obligations of Chardan and succeed to those benefits enjoyed by Chardan. The business of Chardan, upon the reincorporation and the acquisition of the HollySys Companies will become that of HollySys.

You do not need to replace the current stock certificate of Chardan after the Redomestication Merger. **DO NOT DESTROY YOUR CURRENT STOCK CERTIFICATES ISSUED BY CHARDAN.** The issued and outstanding stock certificates of Chardan will represent the rights that our stockholders will have in HLS. Stockholders, however, may submit their stock certificates to our transfer agent, Continental Stock Transfer and Trust Company, 17 Battery Place, New York, New York 10004 (212-509-4000) for new certificates, subject to normal requirements as to proper endorsement, signature guarantee, if required, and payment of applicable taxes.

If you have lost your certificate, you can contact our transfer agent to have a new certificate issue. You may be requested to post a bond or other security to reimburse us for any damages or costs if the lost certificate is later delivered for sale or transfer.

### **Management of HLS**

The directors of HLS will be seven persons. These will be Wang Changli, Qiao Li, Kerry S. Propper, and four independent directors. The officers of HLS will be Dr. Wang Changli (chief executive officer) and Madame Qiao Li (chairperson). See "Directors and Management of the Combined Company following the Stock Purchase."

Wang Changli and Qiao Li will be employed by Gifted Time Holdings pursuant to written employment agreements described above.

### **Conversion Rights**

Any stockholder of Chardan holding shares of common stock issued in Chardan's initial public offering who votes against the Redomestication Merger may, at the same time, demand that Chardan convert his or her shares into a pro rata portion of the trust account as of the record date. If the stockholder makes that demand and the Redomestication Merger is consummated, Chardan will convert these shares into a pro rata portion of funds held in the trust account plus interest, as of the record date. Alternatively, Chardan stockholders who vote against the Redomestication Merger may elect to exercise their appraisal rights under Delaware law as discussed in the section below. Because the exercise of the conversion rights and the appraisal rights both require a tender of the holder's shares to Chardan, only one right may be elected in respect of the shares.

The closing price of Chardan's common stock on \_\_\_\_\_, 2006 (the record date) was \$\_\_\_\_\_ and the per-share, pro-rata cash held in the trust account on that date was approximately \$\_\_\_\_\_. Prior to exercising conversion rights, Chardan stockholders should verify the market price of Chardan's common stock as they may receive higher proceeds from the sale of their common stock in the public market than from exercising their conversion rights, if the market price per share is higher than the conversion price.

If the holders of 1,150,000 or more shares of common stock issued in Chardan's initial public offering (an amount equal to 20% or more of these shares), vote against the stock purchase and demand conversion of their shares, Chardan will not be able to consummate the stock purchase.

If you exercise your conversion rights, then you will be exchanging your shares of Chardan common stock for cash and will no longer own these shares. You will be entitled to receive cash for these shares only if you continue to hold

these shares through the effective time of the stock purchase and then tender your stock certificate to the combined company.

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## **Appraisal Rights**

If the Redomestication Merger occurs, the Chardan stockholders who do not vote in favor of the Redomestication Merger have the right to demand in cash the fair value of their Chardan shares (exclusive of any element of value arising from the accomplishment or expectation of the merger) instead of taking the surviving corporation's common stock or exercising their conversion rights as described above. Holders of options or warrants to purchase Chardan common stock do not have any appraisal rights. Unlike conversion rights in which the stockholder will receive a pro rata portion of the trust account as of the record date, stockholders who elect to exercise their appraisal rights will receive a value for their shares that is determined by an appraisal made by the Delaware Court of Chancery.

Chardan common stock will not be converted into surviving corporation common stock if the holder of the shares validly exercises and perfects statutory appraisal rights with respect to the shares. When and if the holder of those shares withdraws the demand for appraisal or otherwise becomes ineligible to exercise appraisal rights, the shares will automatically convert into shares of the surviving corporation common stock on the same basis as the other shares that convert in the Redomestication Merger.

To perfect the appraisal right, stockholders must not vote in favor of the Redomestication Merger and must then mail or deliver a written demand for appraisal, before the taking of the vote on the merger at the special meeting of Chardan stockholders. This written demand must be separate from any written consent or vote against approval of the Redomestication Merger. Voting against approval of the Redomestication Merger or failing to vote on the proposal will not constitute a demand for appraisal within the meaning of Section 262 of the Delaware General Corporations Law. The written demand should be delivered to:

Chardan North China Acquisition Corporation  
625 Broadway, Suite 1111  
San Diego, CA 92101  
Attention: Dr. Richard Propper

A written demand for appraisal of the Chardan shares is only effective if it reasonably informs Chardan of the identity of the stockholder and that the stockholder demands appraisal of his, her or its shares. Accordingly, the written demand for appraisal should specify the stockholder's name and mailing address, the number of shares of Chardan stock owned and that the stockholder is thereby demanding appraisal.

A dissenting stockholder who is the record owner, such as a broker, of Chardan stock as a nominee for others, may exercise a right of appraisal with respect to the common stock held for one or more beneficial owners, while not exercising such right for other beneficial owners. In that case, the record stockholder should specify in the written demand the number of shares as to which the stockholder wishes to demand appraisal. If the written demand does not expressly specify the number of shares, Chardan will assume that the written demand covers all the shares of Chardan common stock that are in the nominee's name.

It is important that Chardan receive all written demands promptly as provided above. Failure to comply with any of these conditions will result in the stockholder only being entitled to receiving the shares of HLS in the Redomestication Merger.

Dissenting stockholders must not vote to approve the Redomestication Merger. If a dissenting stockholder votes in favor of the merger, the stockholder's right to appraisal will terminate, even if the stockholder previously filed a written demand for appraisal. A vote against approval of the Redomestication Merger is not required in order to exercise appraisal rights.

Dissenters must continuously hold their shares of Chardan common stock from the date they make the demand for appraisal through the closing of the Redomestication Merger. Record holders of Chardan common stock who make the appraisal demand, but subsequently sell their shares of common stock prior to the merger will lose any right to appraisal in respect of the sold shares.

Within 120 days after the effective date of the merger, which date shall be provided to the stockholders by a written notice from Chardan in accordance with Section 262, either the surviving corporation or any stockholder who has complied with the conditions of Section 262 may file a petition in the Delaware Court of Chancery demanding that the Chancery Court determine the fair value of the shares of stock held by all the stockholders who are entitled to appraisal rights. Neither Chardan nor the surviving corporation has any intention at this time of filing this petition. Because the surviving corporation has no obligation to file this petition, if no dissenting stockholder files this petition within 120 days after the closing, the dissenting stockholder will lose its rights of appraisal.

A dissenting stockholder who no longer wishes to exercise appraisal rights must withdraw the holder's demand for appraisal rights within 60 days after the effective date of the Redomestication Merger. A stockholder also may withdraw a demand for appraisal after 60 days after the effective date of the merger, but only with the written consent of the surviving corporation. If a stockholder effectively withdraws a demand for appraisal rights, the stockholder will receive the merger consideration provided in the Redomestication Merger.

If the stockholder is in compliance with the demand requirements, the stockholder is entitled to receive from the surviving corporation a statement setting for the aggregate number of shares for which appraisal has been demanded and the aggregate number of stockholders making the demand. To obtain this statement, the stockholder must make a written demand to the surviving corporation within 120 days after the effective date of the Redomestication Merger. The surviving corporation must make the statement before the later of (i) the 10th day after receiving such request or (ii) the 10th day after the expiration of the period within which demand for appraisal rights must be made.

If a Chancery Court proceeding is commenced by a dissenting stockholder, the surviving corporation has 20 days to provide the court with the names of dissenting stockholders with which it has not settled a claim for appraisal. The court may then send notice of a hearing to all the stockholders demanding appraisal rights, and then conduct a hearing to determine whether the stockholders have fully complied with Section 262 (i.e., providing a written demand for appraisal and filing the petition for appraisal within the applicable time frames) their entitlement to the appraisal rights under that section. The court may require deposit of the stock certificates of dissenting stockholders with the court. A dissenting stockholder who does not follow this requirement may be dismissed from the proceeding.

The Chancery Court will determine the value of the shares. To determine the fair value, the court will consider all relevant factors, and will exclude any appreciation or depreciation due to the anticipation or accomplishment of the Redomestication Merger. Whether or not an investment banking firm has determined that the merger is fair is not an opinion that the merger consideration is fair value under Section 262. Upon determination of the value, the surviving corporation will be ordered to pay that value, together with simple or compound interest as the court directs. To receive payment, the dissenting stockholders must surrender their stock certificates to the surviving corporation.

The costs of the appraisal proceeding may be assessed against the surviving corporation and the stockholders as the court determines.

**Differences of Stockholder Rights**

Upon the completion of the reincorporation, the memorandum and articles of association of HLS will become the governing documents of the surviving corporation. Although the corporate statutes of Delaware and the British Virgin Islands are similar, certain differences exist. The most significant differences, in the judgment of the management of Chardan are summarized below. Stockholders should refer to the annexes of the memorandum and articles of association and to the Delaware corporate law and corporate law of the British Virgin Islands, including the Business Companies Act (“BCA”) to understand how these laws apply to Chardan and HLS and may affect you. Neither British Virgin Islands law nor the memorandum and articles of association of HLS impose any limitations on the right of nonresident or foreign owners to hold or vote securities. Under the British Virgin Islands law, holders of a company’s stock are referred to as members, as opposed to stockholders, which reference is carried through in the table.

<b>Provision</b>	<b>Chardan</b>	<b>HLS</b>
Number of Authorized Shares	21 million shares of which 20 million are shares of common stock, \$.0001 par value per share and 1 million are shares of preferred stock, par value \$.0001 per share	101 million shares of which 100 million are ordinary shares; and 1 million are preference shares, each with a par value of \$.001 per share
Par Value	Stated in United States dollars. Changes in capital generally require stockholder approval	No par value Changes in capital may be made upon resolution of members or directors.
Preferred (Preference) Shares	Directors may fix the designations, powers, preferences, rights, qualifications, limitations and restrictions by resolution.	Same as Chardan, but subject to the memorandum.
Registered Shares	Shares of capital stock of Chardan to be registered shares.	Same as Chardan
Purpose of Corporation	To engage in any lawful act not prohibited by law.	Same as Chardan subject to the prohibition of conducting certain business activities in the BVI ( <i>i.e.</i> , banking, insurance and local BVI businesses).
Amendment of Certificate of Incorporation	Requires stockholder vote and, except in limited circumstances, by the board of directors.	Requires vote of the members, being a person that holds shares, or as permitted by the BCA by the board of directors and articles.
Registered Office	9 East Loockerman Street Kent County Dover, Delaware	P.O. Box 173 Kingston Chambers Road Town, Tortola, British Virgin Islands
Transfer Agent	Continental Stock Transfer & Trust Company	Same as Chardan
Voting Rights		Same as Chardan

Common stock: one share, one vote on all matters before the holders of the common stock.

Other classes of equity may have voting rights as assigned to them by the board of directors or as approved by stockholders.

Directors elected by plurality, all other matters either by majority of issued and outstanding or majority of those present and entitled to vote as specified by law.

Directors elected by plurality as provided in memorandum and articles; all other matters by a majority of those shares present and entitled to vote.

<b>Provision</b>	<b>Chardan</b>	<b>HLS</b>
Redemption of Equity	Shares may be repurchased or otherwise acquired, provided the capital of the company will not be impaired by the acquisition. Company may hold or sell treasury shares.	Same as Chardan
Stockholder/Member consent	Permitted as required for a vote at a meeting	Same as Chardan
Notice Requirements for Stockholder/Member Nominations and Other Proposals	In general, to bring a matter before an annual meeting or to nominate a candidate for director, a stockholder must give notice of the proposed matter or nomination not less than 60 days and not more than 90 days prior to public disclosure of the date of annual meeting. In the event that less than 70 days notice or prior public disclosure of the date of the meeting is given or made to stockholder, to be timely, the notice must be received by the company no later than the close of business on the 10th day following the day on which such notice of the date of the meeting was mailed or public disclosure was made, whichever first occurs.	To bring a matter before an annual meeting or to nominate a candidate for director, a member must give notice to the company of not less than 30 days nor more than 60 days. If the member is making a proposal on a matter or nominating a candidate for director and there is less than 40 days notice or prior public disclosure of the date is given or made to members, to be timely, must be received no later than the close of business on the 10th day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made.
Meetings of Stockholders/Members - Presence	In person or by proxy or other appropriate electronic means.	In person or by proxy or by any teleconference means where persons can hear one another.
Meeting of Stockholder/Member - Notice	Not less than 10 days or more than 60 days.	Not less than seven days; no maximum limit.
Meeting of Stockholders/Members - Call of Meeting	Regular and annual meetings shall be called by the directors. Special meetings may be called only by majority of board of directors, chief executive officer or by a majority of the issued and outstanding capital stock entitled to vote.	Meetings may be called by the directors or by members holding 30 percent of the outstanding votes. The articles require an annual meeting of the members for the election of directors to be called by the directors. Meetings on short notice may be called upon waiver or presence of all the members holding shares entitled to vote or 90% of the total number of shares entitled to vote agree to short notice.

Meeting of Stockholders /Members- Place	Within or without Delaware	Within or outside the BVI as the directors consider necessary or desirable.
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<b>Provision</b>	<b>Chardan</b>	<b>HLS</b>
Meeting of Stockholders/Members - Quorum	Majority of the capital stock issued and outstanding and entitled to vote at meeting. Meeting may be adjourned for up to 30 days without additional notice to stockholders.	One-half of the votes of the shares of each class or series entitled to vote. Adjournment for such time as directors determine.
Meeting of Stockholders/Members - Record Date	As fixed by the directors, no more than 60 days and no less than 10 days before the meeting. If not fixed, the day before notice of meeting is given.	As fixed by the directors
Directors - Election	By the stockholders as entitled by their terms, including the holders of common stock.	By the members as entitled by their terms, including the holders of common stock
Directors - Term	Staggered board of three classes; for terms of three years	Annual term
Directors - Removal	By the stockholders for cause.	By resolution of the members for cause or without cause on a vote of the members representing 66-2/3 of the shares entitled to vote or the directors for any reason on a resolution signed by all the other directors absent from meetings for six months without leave of the board, death or incapacity.
Directors - Vacancy	May be filled by majority of remaining directors (unless they are the result of the action of stockholders) and newly created vacancies may be filled by majority of remaining directors.	May be filled by members or the board of directors.
Directors - Number	Unless established by certificate of incorporation, as determined by board of directors, but not less than one.	Same as Chardan.
Directors - Quorum and Vote Requirements	A majority of the entire board. The affirmative vote of a majority of directors present at a meeting at which there is a quorum constitutes action by the board of directors.	One-half of the total number of directors, present in person or by alternate, except if there are only two or less directors then a quorum will be all the directors.
Directors - Managing Director	Not applicable	Provision for the board to select one or more directors to be managing directors, provide for special remuneration and assign such powers as the board

		determines so long as it is not a power that requires board approval.
Directors - Powers	All powers to govern the corporation not reserved to the stockholders.	Same as Chardan
Directors - Committees	Directors may establish one or more committees with the authority that the board determines.	Same as Chardan

<b>Provision</b>	<b>Chardan</b>	<b>HLS</b>
Directors - Consent Action	Directors may take action by written consent of all directors, in addition to action by meeting.	By written consent in same manner as if at a meeting in persons, by directors or by alternate.
Director - Alternates	Not permitted	Directors may, by written instrument, appoint an alternate who need not be a director, who may attend meetings in the absence of the director and vote and consent in the place of the directors.
Directors - Appoint Officers	Directors appoint the officers of the corporation, subject to the by-laws, with such powers as they determine.	Same as Chardan, subject to the articles of association
Director - Limitation of Liability	Directors liability is limited, except for (i) breach of loyalty, (ii) act not in good faith or which involves international misconduct or a knowing violation of law, (iii) willful violation of law in respect of payment of dividend or redeeming shares, or (iv) actions in which director receives improper benefit.	Duty to act honestly and in good faith with a view to the best interests of the company and exercise care, diligence and skill of a reasonably prudent person acting in comparable circumstances. No provisions in the memorandum, articles or agreement may relieve a director, officer, or agent from the duty to act in accordance with the memorandum or articles or from personal liability arising from the management of the business or affairs of the company.
Director - Indemnification Insurance	Company may purchase insurance in relation to any person who is or was a director or officer of the company.	Same as Chardan, extends to a liquidator of the company.
Amendments to Organizational Documents	Amendments must be approved by the board of directors and by a majority of the outstanding stock entitled to vote on the amendment, and if applicable, by a majority of the outstanding stock of each class or series entitled to vote on the amendment as a class or series. By-laws may be amended by the stockholders entitled to vote at any meeting or, if so provided by the certificate of incorporation, by the board of directors.	Amendments to the memorandum and articles may be made by resolution of the members or by the directors.
Sale of Assets	The sale of all or substantially all the assets of the company requires stockholder approval.	The sale of more than 50% of the assets of the company requires

member approval.

Dissenters Rights	Provision is made under Delaware corporate law to dissent and obtain fair value of shares in connection with certain corporate actions that require stockholder approval or consent.	Provision is made under the BCA to dissent and obtain fair value of shares in connection with certain corporate actions that require member approval or consent.
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### **Indemnification Of Officers And Directors**

As indicated in the comparison of charter provisions, a director, officer or agent of a company formed under the laws of the British Virgin Islands is obligated to act honestly and in good faith and exercise care, diligence and skill of a reasonably prudent person acting in comparable circumstances. The Memorandum and Articles of HLS do not relieve directors, officers or agents from personal liability arising from the management of the business of the company. Notwithstanding the foregoing, Section 132 of the Business Companies Act of the British Virgin Islands may indemnify directors, officers and agents against all expenses, including legal fees and judgments, fines and settlements, in respect of actions related to their employment. The Stock Purchase Agreement provides indemnification in respect of the representations, warranties and covenants of the parties, some of which may relate to the securities laws of the United States. There are no agreements that relieve directors, officer or agents from personal liability. HLS is permitted and intends to obtain director and officer insurance.

Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended, may be permitted to directors, officers or persons controlling the registrant pursuant to the foregoing provisions, HLS and Chardan have been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy, as expressed in the Securities Act of 1933, as amended, and is, therefore, unenforceable.

### **Defenses Against Hostile Takeovers**

While the following discussion summarizes the reasons for, and the operation and effects of, the principal provisions of HLS's Memorandum and Articles of Association that management has identified as potentially having an anti-takeover effect, it is not intended to be a complete description of all potential anti-takeover effects, and it is qualified in its entirety by reference to the full texts of HLS's Memorandum and Articles of Association.

In general, the anti-takeover provisions of HLS's Memorandum and Articles of Association are designed to minimize susceptibility to sudden acquisitions of control that have not been negotiated with and approved by HLS's board of directors. As a result, these provisions may tend to make it more difficult to remove the incumbent members of the board of directors. The provisions would not prohibit an acquisition of control of HLS or a tender offer for all of HLS's capital stock. The provisions are designed to discourage any tender offer or other attempt to gain control of HLS in a transaction that is not approved by the board of directors, by making it more difficult for a person or group to obtain control of HLS in a short time and then impose its will on the remaining stockholders. However, to the extent these provisions successfully discourage the acquisition of control of HLS or tender offers for all or part of HLS's capital stock without approval of the board of directors, they may have the effect of preventing an acquisition or tender offer which might be viewed by stockholders to be in their best interests.

Tender offers or other non-open market acquisitions of stock will generally be made at prices above the prevailing market price of HLS's stock. In addition, acquisitions of stock by persons attempting to acquire control through market purchases may cause the market price of the stock to reach levels that are higher than would otherwise be the case. Anti-takeover provisions may discourage such purchases, particularly those of less than all of HLS's stock, and may thereby deprive stockholders of an opportunity to sell their stock at a temporarily higher price. These provisions may therefore decrease the likelihood that a tender offer will be made, and, if made, will be successful. As a result, the provisions may adversely affect those stockholders who would desire to participate in a tender offer. These provisions may also serve to insulate incumbent management from change and to discourage not only sudden or hostile takeover attempts, but also any attempts to acquire control that are not approved by the board of directors, whether or not stockholders deem such transactions to be in their best interest.

*Stockholder Meetings.* British Virgin Island law provides that stockholder meetings shall be convened by the board of directors at any time or upon the written request of stockholders holding more than 30% of the votes of the outstanding voting shares of the company. HLS's Articles of Association provide that annual stockholder meetings for the election of directors may be called only by the directors.

*Number of Directors and Filling Vacancies on the Board of Directors.* British Virgin Island law requires that the board of directors of a company consist of one or more members and that the number of directors shall be set by the corporation's Articles of Association, with a minimum of one director. HLS's Articles of Association provide that the number of directors shall be not less than one, subject to any subsequent amendment to change the number of directors. The power to determine the number of directors is vested in the board of directors. The power to fill vacancies, whether occurring by reason of an increase in the number of directors or by resignation, is vested primarily in the board of directors. Directors may be removed by the members only for cause or without cause on a vote of the members representing 66-2/3 of the shares entitled to vote.

*Election of Directors.* Under British Virgin Island law, there is no cumulative voting by stockholders for the election of the directors. The absence of cumulative voting rights effectively means that the holders of a majority of the stock

voted at a stockholders meeting may, if they so choose, elect all directors of HLS, thus precluding a small group of stockholders from controlling the election of one or more representatives to the board of directors.

*Advance Notice Requirements for Nomination of Directors and Presentation of New Business at Meetings of Stockholders; Action by Written Consent.* The HLS Articles of Association will provide for advance notice requirements for stockholder proposals and nominations for director. Generally, to be timely, notice must be delivered to the secretary of HLS at its principal executive offices not fewer than 30 days nor more than 60 days prior to the first anniversary date of the annual meeting for the preceding year. Special meetings may be called by HLS's board of directors or by stockholders comprising 50% of the combined voting power of the holders of the then outstanding shares entitled to vote. These provisions make it more procedurally difficult for a stockholder to place a proposal or nomination on the meeting agenda or to take action without a meeting, and therefore may reduce the likelihood that a stockholder will seek to take independent action to replace directors or seek a stockholder vote with respect to other matters that are not supported by management.

### **Rights of Minority Shareholders**

Under the law of the British Virgin Islands, there is little statutory law for the protection of minority shareholders. The principal protection under statutory law is that shareholders may bring an action to enforce the constituent documents of the corporation, the Articles and the Memorandum of Association. Shareholders are entitled to have the affairs of the company conducted in accordance with the general law and the articles and memorandum. The company is obliged to hold an annual general meeting and provide for the election of directors. Companies are obligated to appoint an independent auditor and shareholders are entitled to receive the audited financial statements of the company.

There are common law rights for the protection of shareholders that may be invoked, largely dependent on English company law, since the common law of the British Virgin Islands for business companies is limited. Under the general rule pursuant to English company law known as the rule in *Foss v. Harbottle*, a court will generally refuse to interfere with the management of a company at the insistence of a minority of its shareholders who express dissatisfaction with the conduct of the company's affairs by the majority or the board of directors. However, every shareholder is entitled to have the affairs of the company conducted properly according to law and the constituent documents of the corporation. As such, if those who control the company have persistently disregarded the requirements of company law or the provisions of the company's memorandum of association or articles, then the courts will grant relief. Generally, the areas in which the courts will intervene are the following: (i) an act complained of which is outside the scope of the authorized business or is illegal or not capable of ratification by the majority, (ii) acts that constitute fraud on the minority where the wrongdoers control the company, (iii) acts that infringe on the personal rights of the shareholders, such as the right to vote, and (iv) where the company has not complied with provisions requiring approval of a special or extraordinary majority of shareholders.

Under the law of Delaware, the rights of minority shareholders are similar to that which will be applicable to the shareholders of HLS. The principal difference, as discussed elsewhere will be the methodology and the forum for bringing such an action. It is also generally the case that the Delaware courts can exercise a wide latitude in interpretation and wide discretion in fashioning remedies as they think fits the circumstances for the regulation of the company. Under English precepts of the law of minority shareholders, there is generally a more restricted approach to the enforcement of the rights through the interpretation of the law, articles and memorandum.

### **Federal Income Tax Consequences of the Reincorporation**

The Redomestication Merger has been structured to qualify as a reorganization under section 368(a) of the Code for federal income tax purposes. For United States federal income tax purposes, no gain or loss will be recognized by the stockholders of Chardan who receive HLS common stock for their Chardan common stock in connection with the Redomestication Merger. The aggregate tax basis of the HLS common stock received by a Chardan stockholder in connection with the Redomestication Merger will be the same as the aggregate tax basis of the Chardan common stock surrendered in exchange for HLS common stock. A stockholder who holds Chardan common stock will include

in his holding period for the HLS common stock that he receives his holding period for the Chardan common stock. Chardan, however, will recognize gain, but not loss, as a result of the Redomestication Merger equal to the difference, if any, between the adjusted tax basis of any Chardan asset and such asset's fair market value at the effective time of the Redomestication Merger. There is no reciprocal tax treaty between the British Virgin Islands and the United States regarding withholding.

State, local or foreign income tax consequences to stockholders may vary from the federal income tax consequences described above, and **STOCKHOLDERS ARE URGED TO CONSULT THEIR OWN TAX ADVISOR AS TO THE CONSEQUENCES TO THEM OF THE REINCORPORATION UNDER ALL APPLICABLE TAX LAWS.**

## **Transfer of HLS Securities Upon Death of Holder**

Because HLS is a BVI company, the transfer of the securities of HLS, including the common stock and warrants, for estate administration purposes will be governed by BVI law. This may require that the estate of a decedent security holder of HLS seek to probate or transfer under letters of administration for the estate issued by a court in the BVI. HLS has attempted to modify this requirement by inserting in its Articles of Association a provision that permits the board of directors to decide whether or not to permit decedent transfers based on estate documentation from jurisdictions other than the BVI, more in accordance with United States practice, without any action having to be taken in the BVI. The board of directors intends to follow this procedure. There is no assurance that this will result in an enforceable transfer. The board of directors will be fully indemnified for its actions in this regard pursuant to the Articles of Association.

## **CHARDAN 2006 EQUITY PLAN**

### **Background**

The Chardan board of directors has approved the “2006 Stock Plan,” subject to stockholder approval. The plan reserves 3,000,000 shares of Chardan common stock for issuance in accordance with the plan’s terms. The purpose of the stock option plan is to enable Chardan to offer its employees, officers, directors and consultants whose past, present and/or potential contributions to Chardan have been, are or will be important to the success of Chardan, an opportunity to acquire a proprietary interest in Chardan. The various types of incentive awards that may be provided under the stock option plan will enable Chardan to respond to changes in compensation practices, tax laws, accounting regulations and the size and diversity of its business.

There are approximately 1,000 persons who will be eligible to be granted awards, including directors, officers and employees of the HollySys Operating Companies, Gifted Time Holdings and HLS. No allocations of shares that may be subject to awards have been made in respect of the executive officers or any other group. All awards will be subject to the recommendations of management and the compensation committee and approval by the board of directors or the stock option committee.

**A summary of the principal features of the stock option plan is provided below, but is qualified in its entirety by reference to the full text of the plan which is attached to this proxy statement/prospectus as an annex.**

### **Shares Available**

The stock plan reserves 3,000,000 shares of common stock for awards. If Chardan’s stockholders approve this proposal, the total number of shares of common stock available for issuance under the stock plan will be subject to the adjustments described below.

### **Administration**

The stock plan is administered by our compensation committee. Under the stock plan, the compensation committee has full authority, subject to the provisions of the plan, to award any of the following, either alone or in tandem with each other:

- stock options;
- stock appreciation rights;
- restricted stock;

- restricted stock units;
- performance units and shares
- deferred compensation awards; and
- other stock-based awards.

Subject to the provisions of the stock plan, the compensation committee determines, among other things, the persons to whom from time to time awards may be granted, the specific type of award to be granted, the number of shares subject to each award, share prices, any restrictions or limitations on the awards, and any vesting, exchange, deferral, surrender, cancellation, acceleration, termination, exercise or forfeiture provisions related to the awards. The interpretation and construction by the compensation committee of any provisions of, and the determination by the compensation committee of any questions arising under, the plan or any rule or regulation established by the compensation committee pursuant to the plan is final and binding on all persons interested in the plan.

### **Stock subject to the plan**

The plan authorizes a total of 3,000,000 shares of common stock to be granted as awards under the plan. In order to prevent the dilution or enlargement of the rights of holders under the plan, our compensation committee may determine whether or not to adjust the terms of the awards or the number of shares reserved for issuance under the plan in the event of any stock split, reverse stock split, stock dividend payable on our shares of common stock, combination or exchange of shares, or other extraordinary event occurring after the grant of an award. Shares of our common stock that are awarded under the plan may be either treasury shares or authorized but unissued shares. Treasury shares are those purchased or acquired by us from a stockholder or in the public market. If any award granted under the plan is forfeited or terminated, the shares of common stock reserved for issuance pursuant to the award will be made available for future award grants under the plan.

### **Eligibility**

Subject to the provisions of the plan, awards may be granted to key employees, officers, directors and consultants who are deemed to have rendered or are able to render significant services to us or our subsidiaries and who are deemed to have contributed or to have the potential to contribute to our success. Incentive stock options may only be awarded to individuals who are our employees at the time of grant. Notwithstanding the foregoing, an award may be granted to an individual in connection with his or her hiring or retention, or at any time on or after the date he or she reaches an agreement with us, either oral or in writing, with respect to his or her hiring, even though it may be prior to the date he or she first performs services for us or our subsidiaries. However, no portion of any award of this nature can vest prior to the date that the individual first performs the services he or she was hired or retained to perform.

### **Types of awards**

Options. Under the plan, our compensation committee may award to participants stock options that:

- are intended to qualify as “incentive stock options” within the meaning of Section 422 of the Code; or
- are not intended to be so qualified.

Incentive stock options may only be awarded to our employees and those of our subsidiaries. To the extent that any stock option intended to qualify as an incentive stock option does not so qualify it will constitute a non-incentive stock option.

Our compensation committee will fix the term of each stock option. However, an incentive stock option may be granted only within the ten-year period commencing from the effective date of the plan and may only be exercised within ten years from the date of grant, or five years from the date of grant in the case of a participant who at the time the stock option is granted owns more than 10% of the total combined voting power of all of our classes of voting securities.

The exercise price of stock options granted under the plan will be determined by our compensation committee at the time of the grant, but in no event will the price be less than the fair market value of the underlying common stock on the last trading day prior to the date the stock option is granted. However, the exercise price of an incentive stock option granted to a 10% stockholder will not be less than 110% of the fair market value of the shares on the last trading day prior to the date the stock option is granted. The number of shares covered by incentive stock options which may first become exercisable by a participant in any calendar year cannot have an aggregate fair market value in excess of \$100,000, measured at the date of grant.

The compensation committee will determine the terms and conditions of stock options and when they will become exercisable. Any requirement that options be exercised in installments may be waived in whole or in part by the compensation committee.

Payment of the exercise price may be made in cash, in shares of our common stock owned by the participant, in a combination of the two, or otherwise, as reflected in the applicable award agreement. Additionally, the compensation committee may permit a participant to elect to pay the exercise price by irrevocably authorizing a third party to sell shares of common stock, or a sufficient portion of the shares, acquired upon exercise of the stock option and pay to us a sufficient portion of the sale proceeds to pay the entire exercise price and any tax withholding resulting from the exercise. The committee may also approve the use of any other legal consideration to exercise a stock option. A participant has no rights as a stockholder with respect to the shares of our common stock underlying a stock option granted under the plan until shares are actually issued upon exercise of the stock option.

Stock appreciation rights . Under the plan, our compensation committee may grant stock appreciation rights to participants in tandem with or separate from stock options. A tandem stock appreciation right entitles the holder to surrender to us all or a portion of a stock option in exchange for a number of shares of our common stock determined by multiplying the excess of the fair market value per share of our common stock on the exercise date over the exercise price per share by the number of shares subject to the stock option and then dividing it by the fair market value of the common stock on the date the stock appreciation right is exercised. In the case of an incentive stock option, a tandem stock appreciation right may only be granted simultaneously with the grant of the underlying incentive stock option. In the case of non-incentive stock option, a tandem stock appreciation right may be granted at or after the time of the grant of the underlying non-incentive stock option. A tandem stock appreciation right will terminate upon termination or exercise of the related stock option. Upon exercise of a tandem stock appreciation right, the underlying stock option will be deemed to have been exercised, and the related shares of our common stock will no longer be available for issuance under the plan.

Restricted Stock Awards. The committee may grant restricted stock awards under the stock plan either in the form of a restricted stock purchase right, giving a participant an immediate right to purchase common stock, or in the form of a restricted stock bonus, for which the participant furnishes consideration in the form of services to the company. The committee determines the purchase price payable under restricted stock purchase awards, which may be less than the then current fair market value of our common stock. Restricted stock awards may be subject to vesting conditions based on such service or performance criteria as the committee specifies, including the attainment of one or more performance goals similar to those described below in connection with performance awards. Shares acquired pursuant to a restricted stock award may not be transferred by the participant until vested. Unless otherwise provided by the committee, a participant will forfeit any shares of restricted stock as to which the restrictions have not lapsed prior to the participant's termination of service. Participants holding restricted stock will generally have the right to vote the shares and to receive any dividends paid, except that dividends or other distributions paid in shares will be subject to the same restrictions as the original award.

Restricted Stock Units. The committee may grant restricted stock units under the stock plan, which represent a right to receive shares of our common stock at a future date determined in accordance with the participant's award agreement. No monetary payment is required for receipt of restricted stock units or the shares issued in settlement of the award, the consideration for which is furnished in the form of the participant's services to the company. The committee may grant restricted stock unit awards subject to the attainment of one or more performance goals similar to those described below in connection with performance awards, or may make the awards subject to vesting conditions similar to those applicable to restricted stock awards. Unless otherwise provided by the committee, a participant will forfeit any restricted stock units which have not vested prior to the participant's termination of service. Participants have no voting rights or rights to receive cash dividends with respect to restricted stock unit awards until shares of common stock are issued in settlement of such awards. However, the committee may grant restricted stock units that entitle their holders to receive dividend equivalents, which are rights to receive additional restricted stock units for a number of shares whose value is equal to any cash dividends we pay.

Performance Awards. The committee may grant performance awards subject to such conditions and the attainment of such performance goals over such periods as the determines in writing and sets forth in a written agreement between the company and the participant. To the extent compliance with Section 162(m) of the Code is desired, a committee comprised solely of "outside directors" under Section 162(m) shall act with respect to performance awards. These awards may be designated as performance shares or performance units. Performance shares and performance units are unfunded bookkeeping entries generally having initial values, respectively, equal to the fair market value determined on the grant date of a share of common stock and a value set by the committee. Performance awards will specify a predetermined amount of performance shares or performance units that may be earned by the participant to the extent that one or more predetermined performance goals are attained within a predetermined performance period. To the extent earned, performance awards may be settled in cash, shares of common stock (including shares of restricted stock) or any combination thereof.

Prior to the beginning of the applicable performance period or such later date as permitted under Section 162(m) of the Code, the committee will establish one or more performance goals applicable to the award. Performance goals will be based on the attainment of specified target levels with respect to one or more measures of business or financial performance of the company and each subsidiary corporation consolidated with the company for financial reporting purposes, or such division or business unit of the company as may be selected by the committee. The committee, in its discretion, may base performance goals on one or more of the following such measures: sales revenue, gross margin, operating margin, operating income, pre-tax profit, earnings before interest, taxes, depreciation and amortization, net income, expenses, the market price of our common stock, earnings per share, return on stockholder equity, return on capital, return on net assets, economic value added, market share, customer service, customer satisfaction, safety, total stock holder return, free cash flow, or other measures as determined by the committee. The target levels with respect to these performance measures may be expressed on an absolute basis or relative to a standard specified by the committee. The degree of attainment of performance measures will be calculated in accordance with generally accepted accounting principles, but prior to the accrual or payment of any performance award for the same performance period, and, according to criteria established by the committee, excluding the effect (whether positive or negative) of changes in accounting standards or any extraordinary, unusual or nonrecurring item occurring after the establishment of the performance goals applicable to a performance award.

Following completion of the applicable performance period, the committee will certify in writing the extent to which the applicable performance goals have been attained and the resulting value to be paid to the participant. The committee retains the discretion to eliminate or reduce, but not increase, the amount that would otherwise be payable on the basis of the performance goals attained to a participant who is a “covered employee” within the meaning of Section 162(m) of the Code. However, no such reduction may increase the amount paid to any other participant. The committee may make positive or negative adjustments to performance award payments to participants other than covered employees to reflect the participant’s individual job performance or other factors determined by the committee. In its discretion, the committee may provide for the payment to a participant awarded performance shares of dividend equivalents with respect to cash dividends paid on the company’s common stock. The committee may provide for performance award payments in lump sums or installments. If any payment is to be made on a deferred basis, the committee may provide for the payment of dividend equivalents or interest during the deferral period.

Unless otherwise provided by the committee, if a participant’s service terminates due to the participant’s death or disability prior to completion of the applicable performance period, the final award value will be determined at the end of the performance period on the basis of the performance goals attained during the entire performance period but will be prorated for the number of months of the participant’s service during the performance period. If a participant’s service terminates prior to completion of the applicable performance period for any other reason, the stock plan provides that, unless otherwise determined by the committee, the performance award will be forfeited. No performance award may be sold or transferred other than by will or the laws of descent and distribution prior to the end of the applicable performance period.

Deferred Compensation Awards. The stock plan authorizes the committee to establish a deferred compensation award program. If and when implemented, participants designated by the committee who are officers, directors or members of a select group of highly compensated employees may elect to receive, in lieu of compensation otherwise payable in cash or in lieu of cash or shares of common stock issuable upon the exercise or settlement of stock options, stock appreciation rights or performance share or performance unit awards, an award of deferred stock units. Each such stock unit represents a right to receive one share of our common stock at a future date determined in accordance with the participant’s award agreement. Deferred stock units are fully vested upon grant and will be settled by distribution to the participant of a number of whole shares of common stock equal to the number of stock units subject to the award as soon as practicable following the earlier of the date on which the participant’s service terminates or a settlement date elected by the participant at the time of his or her election to receive the deferred stock unit award. Participants are not required to pay any additional consideration in connection with the settlement of a deferred stock units. A holder of deferred stock units has no voting rights or other rights as a stockholder until shares of common stock are issued to the participant in settlement of the stock units. However, participants holding deferred stock units will be entitled to receive dividend equivalents with respect to any payment of cash dividends on an equivalent number of shares of common stock. Such dividend equivalents will be credited in the form of additional whole and fractional stock units determined in accordance with a method specified by the committee in the participant’s award agreement. Prior to settlement, deferred stock units may not be assigned or transferred other than by will or the laws of descent and distribution.

Other stock-based awards . Our compensation committee may award other stock-based awards, subject to limitations under applicable law, in addition to, or in lieu of, other awards granted to participants under the plan. These other stock-based awards are payable in, valued in, or otherwise based on, or related to, our shares of common stock or dividends on our common stock. Subject to the terms of the plan, the compensation committee has complete discretion to determine the terms and conditions of other stock-based awards. Other stock-based awards may be awarded either alone, in addition to, or in tandem with any other awards under the plan or any other plan in effect.

### **Withholding taxes**

We may withhold, or require participants to remit to us, an amount sufficient to satisfy any federal, state or local withholding tax requirements associated with awards under the plan. If permitted by our compensation committee, tax withholding may be settled with shares of our common stock, including shares that are part of the award that gives rise to the withholding requirement.

Awards may, in some cases, result in the deferral of compensation that is subject to the requirements of Code Section 409A. To date, the U.S. Treasury Department and Internal Revenue Service have issued only preliminary guidance regarding the impact of Code Section 409A on the taxation of these types of awards. Generally, to the extent that deferrals of these awards fail to meet certain requirements under Code Section 409A, such awards will be subject to immediate taxation and tax penalties in the year they vest unless the requirements of Code Section 409A are satisfied. It is the intent of the Company that awards under the 2006 Plan will be structured and administered in a manner that complies with the requirements of Code Section 409A.

### **Agreements; Transferability**

Stock options, stock appreciation rights, restricted stock, deferred stock, stock reload options and other stock-based awards granted under the plan will be evidenced by agreements consistent with the plan in a form as prescribed by the compensation committee. Neither the plan nor agreements evidencing awards under the plan confer any right to continued employment upon any holder of a stock option, stock appreciation right, restricted stock, deferred stock, stock reload option or other stock-based award. Further, except as:

expressly provided in the plan,

expressly provided in the grant of an award, or

discussed above with respect to the transferability of stock options in certain limited exceptions,

all agreements will provide that the right to exercise stock options, receive restricted stock after the expiration of the restriction period or deferred stock after the expiration of the deferral period, receive payment under other stock-based awards, or exercise a stock appreciation right cannot be transferred except by will or the laws of descent and distribution.

Stock options may not be assigned or transferred by a participant except by will or by the laws of descent and distribution, and during the lifetime of a participant, the stock options may only be exercisable by the person to whom it was granted, or, to the extent of legal incapacity or incompetency, the participant's guardian or legal representative. Notwithstanding the foregoing, with the approval of the compensation committee, a participant may transfer a nonstatutory stock option:

by gift, for no consideration, or pursuant to a domestic relations order, in either case, to or for the benefit of the participant's immediate family; or

to an entity in which the participant or members of the participant's immediate family own more than fifty percent of the voting interest, in exchange for an interest in that entity.

Additionally, the transfer will be subject to any additional limits that the compensation committee may establish and the execution of any documents that the compensation committee may require. If a transfer of this nature is made, the transferee shall remain subject to all the terms and conditions applicable to the stock option prior to the transfer.

## **Term and amendments**

The plan will terminate when there are no awards outstanding and when no further awards may be granted. Our board of directors has the right to amend, suspend or discontinue any provision of the plan, provided that the action may not adversely affect awards previously granted between a participant and us without the participant's consent.

## **Federal income tax consequences**

*Incentive Stock Options.* An optionee recognizes no taxable income for regular income tax purposes as the result of the grant or exercise of an incentive stock option. Optionees who do not dispose of their shares for two years following the date the incentive stock option was granted or within one year following the exercise of the option will normally recognize a long-term capital gain or loss equal to the difference, if any, between the sale price and the purchase price of the shares. If an optionee satisfies both such holding periods upon a sale of the shares, we will not be entitled to any deduction for federal income tax purposes. If an optionee disposes of shares either within two years after the date of grant or within one year from the date of exercise (referred to as a "disqualifying disposition"), the difference between the fair market value of the shares on the exercise date and the option exercise price (not to exceed the gain realized on the sale if the disposition is a transaction with respect to which a loss, if sustained, would be recognized) will be taxed as ordinary income at the time of disposition. Any gain in excess of that amount will be a capital gain. If a loss is recognized, there will be no ordinary income, and such loss will be a capital loss. A capital gain or loss will be long-term if the optionee's holding period is more than 12 months. Any ordinary income recognized by the optionee upon the disqualifying disposition of the shares generally should be deductible by the Company for federal income tax purposes, except to the extent such deduction is limited by applicable provisions of the Code or the regulations thereunder. The difference between the option exercise price and the fair market value of the shares on the exercise date of an incentive stock option is an adjustment in computing the optionee's alternative minimum taxable income and may be subject to an alternative minimum tax which is paid if such tax exceeds the regular tax for the year. Special rules may apply with respect to certain subsequent sales of the shares in a disqualifying disposition, certain basis adjustments for purposes of computing the alternative minimum taxable income on a subsequent sale of the shares and certain tax credits which may arise with respect to optionees subject to the alternative minimum tax.

*Nonstatutory Stock Options and Stock Appreciation Rights.* Nonstatutory stock options and stock appreciation rights have no special tax status. A holder of these awards generally does not recognize taxable income as the result of the grant of such award. Upon exercise of a nonstatutory stock option or stock appreciation right, the holder normally recognizes ordinary income in an amount equal to the difference between the exercise price and the fair market value of the shares on the exercise date. If the holder is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of stock acquired by the exercise of a nonstatutory stock option or stock appreciation right, any gain or loss, based on the difference between the sale price and the fair market value on the exercise date, will be taxed as capital gain or loss. A capital gain or loss will be long-term if the holding period of the shares is more than 12 months. We generally should be entitled to a deduction equal to the amount of ordinary income recognized by the optionee as a result of the exercise of a nonstatutory stock option or stock appreciation right, except to the extent such deduction is limited by applicable provisions of the Code or the regulations thereunder. No tax deduction is available to us with respect to the grant of a nonstatutory stock option or stock appreciation right or the sale of the stock acquired pursuant to such grant.

*Restricted Stock.* A participant acquiring restricted stock generally will recognize ordinary income equal to the fair market value of the shares on the “determination date.” The “determination date” is the date on which the participant acquires the shares unless the shares are subject to a substantial risk of forfeiture and are not transferable, in which case the determination date is the earlier of (i) the date on which the shares become transferable or (ii) the date on which the shares are no longer subject to a substantial risk of forfeiture. If the determination date is after the date on which the participant acquires the shares, the participant may elect, pursuant to Section 83(b) of the Code, to have the date of acquisition be the determination date by filing an election with the Internal Revenue Service no later than 30 days after the date on which the shares are acquired. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of shares acquired pursuant to a restricted stock award, any gain or loss, based on the difference between the sale price and the fair market value on the determination date, will be taxed as capital gain or loss. We generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant on the determination date, except to the extent such deduction is limited by applicable provisions of the Code.

*Performance and Restricted Stock Unit Awards.* A participant generally will recognize no income upon the receipt of a performance share, performance unit or restricted stock unit award. Upon the settlement of such awards, participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any substantially vested shares received. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. If the participant receives shares of restricted stock, the participant generally will be taxed in the same manner as described above (see discussion under “Restricted Stock”). Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value on the “determination date” (as defined above under “Restricted Stock”), will be taxed as capital gain or loss. We generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant on the determination date, except to the extent such deduction is limited by applicable provisions of the Code.

*Deferred Compensation Awards.* A participant generally will recognize no income upon the receipt of deferred compensation awards. Upon the settlement of the awards, the participant normally will recognize ordinary income in the year of settlement in an amount equal to the fair market value of the shares received. Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value of the shares on the date they are transferred to the participant, will be taxed as capital gain or loss. We generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant, except to the extent such deduction is limited by applicable provisions of the Internal Revenue Code.

*Potential Limitation on Company Deductions.* Code Section 162(m) denies us a deduction to the Company for compensation paid to certain employees in a taxable year to the extent that compensation exceeds \$1 million for a covered employee. It is possible that compensation attributable to stock options, when combined with all other types of compensation a covered employee receives from us, may cause this limitation to be exceeded in any particular year. Certain kinds of compensation, including qualified “performance-based compensation,” are disregarded for purposes of the deduction limitation. In accordance with applicable regulations issued under Section 162(m), compensation attributable to stock options and stock appreciation rights will qualify as performance-based compensation, provided that: (i) the option plan contains a per-employee limitation on the number of shares for which options or stock appreciation rights may be granted during a specified period, (ii) the per-employee limitation is approved by the stockholders, (iii) the option is granted by a compensation committee comprised solely of “outside directors” (as defined in Section 162(m)) and (iv) the exercise price of the option or right is no less than the fair market value of the stock on the date of grant.

For the aforementioned reasons, the plan provides for an annual per employee limitation as required under Section 162(m). Accordingly, options or stock appreciation rights granted by the compensation committee should be able to qualify as performance-based compensation, and the other awards subject to performance goals may qualify.

*Other Tax Consequences.* The foregoing discussion is intended to be a general summary only of the federal income tax aspects of awards granted under the stock plan; tax consequences may vary depending on the particular circumstances at hand. In addition, administrative and judicial interpretations of the application of the federal income tax laws are subject to change. Furthermore, no information is given with respect to state or local taxes that may be applicable. Participants in the stock plan who are residents of or are employed in a country other than the United States may be subject to taxation in accordance with the tax laws of that particular country in addition to or in lieu of United States federal income taxes.

## INFORMATION ABOUT THE HOLLYSYS OPERATING COMPANIES

### Background

Gifted Time Holdings (through its Chinese operating companies, which are collectively referred to as “HollySys”) is a leader in China's automation and controls industry. It develops, designs, produces, installs and maintains automation and control equipment and systems for a broad array of industries. HollySys has historically focused its efforts in the area of Distributed Control Systems (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, HollySys also has a significant market presence in the basic materials, pharmaceutical and food and beverage processing industries.

Over the past five years, HollySys has devoted significant resources to research and development and sales efforts for market segments it believes will have the greatest growth and margin protection over the coming 10 years.

HollySys is distinguished for its comprehensive capabilities in the domestic industrial automation market, concentrating its focus on the development of the Chinese market. HollySys sells its products and services to, or carries out engineering projects for, national or multi-provincial companies with subsidiaries located in different areas, covering 30 provinces in China. To date, HollySys has served more than 1,700 industrial enterprise customers and undertaken over 3,000 projects.

Currently, HollySys conducts its operations principally through two companies, Beijing HollySys and Hangzhou HollySys. Beijing HollySys also is the majority owner of Beijing HollySys Haotong Science and Development Co., Ltd., which is also engaged in the automation industry, and Beijing HollySys owns less than a controlling interest in several other companies engaged in related activities (the “HollySys Affiliates”). Beijing HollySys was founded in 1996 and has headquarters in Beijing. Hangzhou HollySys was founded in 2003 and is located in Hangzhou. Through its strategy of delivering integrated service, software and hardware and its close affiliations with leading technical and research institutes in China, HollySys has achieved a leading position in the domestic Chinese automation industry.

HollySys' management believes that the quality of its systems is unsurpassed by local Chinese competitors and is comparable to high-end foreign suppliers of Distributed Control Systems. HollySys' project history supports that view. For example after three years of review and analysis, BASF, a large multi-national company, has designated HollySys as a potential qualified Distributed Control Systems vendor for the company, a distinction shared with large multinationals such as ABB and Emerson.

### Market Overview

Since the 1960's, the automation system industry has experienced a steady growth fueled by continuous demand for automation products and services by both traditional process industries and discrete industries in their effort to optimize productivity and improve efficiency. According to ARC Advisory Group, the worldwide Distributed Control Systems market, as measured by revenue, was approximately \$10.3 billion in 2004. Despite large regions of the world experiencing little or no growth, ARC Advisory Group projects that the worldwide Distributed Control Systems market will continue to grow at the average annual rate of 6% through 2009.

The chart below shows the forecast of worldwide Distributed Control Systems market size.

Source: ARC Advisory Group

According to ARC Advisory Group, the Distributed Control Systems 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 Advisory Group projects that the Distributed Control Systems market, as measured by revenue, will exceed \$1400 million by 2010.

The chart below shows the forecast of Distributed Control Systems market size in China.

Source: ARC Advisory Group

ARC Advisory Group also believes that, “China, in contrast to most other countries, provides robust growth prospects for Distributed Control Systems 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. The 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 producers 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.

Due to the rapid increase of investment in fixed assets in China, the Distributed Control Systems market experienced extremely high growth. In 2004, the products and services related to Distributed Control Systems market achieved approximately \$628 million, increasing 26% compared with that of 2003. China Industrial Control Network (CICN) believes that the Distributed Control Systems market will increase about 20%, to approximately \$768 million in 2005. According to a recent market survey by CICN, the Distributed Control Systems market in 2004, the largest segment of industrial automation market in China, is dominated by a few key companies, including ABB, Honeywell, Shanghai Xinhua, Emerson, Yokogawa, Foxboro, Supercon, and Siemens. In terms of market share, HollySys ranks as the second largest supplier in China's Distributed Control Systems market and has established a leadership position in some key segments. The growth in HollySys' revenues has outpaced the growth of the automation market in general.

## **Strategy**

HollySys' goal is to become one of the world's leading automation and process system companies in the near future by expanding upon the strength that has made HollySys the leading domestic automation system provider in China. The principal elements of its core business strategies are so follows:

*Maintaining the leadership position in China's Distributed Control Systems Market.* HollySys seeks to maintain and further strengthen its position in China as the leading provider of Distributed Control Systems system-platform for clients in various industries. Since the majority of HollySys' customers operate in a wide range of process industries, it stands to be a prime beneficiary from the growth of China's economy in these industries. The demand for Distributed Control Systems technology is significant in China and is rapidly growing as more and more small and medium-size enterprises seek technical upgrades that would sustain their competitiveness after China's entry into the World Trade Organization (WTO). HollySys plans to aggressively expand its business to fully exploit the anticipated growing demand of Distributed Control Systems products by the small and medium-size enterprises. HollySys' combination of its patented technologies, close ties with clients, and a comprehensive understanding of the Chinese market should allow it to capitalize on these growth opportunities.

*Enhancing the leadership position in technology.* HollySys has long been recognized as a pioneer in the development of Distributed Control Systems technology as well as applications. It is continuously seeking ways to improve its existing product lines while being committed to the development of new applications. In order to maintain its leadership position in technology, HollySys has devoted significant resources to the research and development process that is undertaken by a group of highly trained and skilled engineers. HollySys plans to concentrate its research and development resources on its core technologies including I/O (Input/Output) signal processing technology (which is used to digitalize information, process the information in computer systems, and finally output the digitalized information to controllers or other output devices by converting it back into analog signals), network protocol interface (which includes hardware and software tools used to communicate between different systems), the Distributed Control Systems platform, (which is a control system that divides control functions into several areas of

responsibility, each managed by its own controller (processor)), software development and application system design, that would further sharpen HollySys' technological edge compared with its competitors.

*Leveraging on a large customer base to offer total solutions.* HollySys provides services offering total solutions, including systems integration and customization of its proprietary technologies. The total solutions approach is favored by Chinese customers and allows HollySys to build and maintain close and long-term relationships with its customers. Along with the maturity of its clients' businesses and their increasing demand for technical upgrades, HollySys expects that two-thirds of the current clients would have the potential needs for the Manufacturing Execution System (MES) and system integrated solutions (which are packages for such functions as plant management, supervisory control and monitoring, plant engineering, and quality management) that can be seamlessly integrated into Distributed Control Systems platforms.

*Focusing on high-value tailored technology services.* HollySys plans to capitalize on its strength in the provision of customer-tailored services for customers, ranging from system design to application, all supported by a team of industrial experts. The customer-tailored services should enable HollySys to achieve a high profit margin while increasing its bidding power. In addition, HollySys also plans to recruit more highly qualified industry experts in the future to bring value to HollySys and its customers.

In addition of aiming for a global leadership position, a secondary goal of HollySys is to carefully expand or migrate to the adjacent markets that can share or strengthen the core business. Through June 2005, HollySys had successfully expanded to the following adjacent markets:

- Migrate the Distributed Control Systems platform to the SCADA (Supervision Control and Data Acquisition) system, which is a computerized system that is capable of gathering and processing data and applying operational controls over long distances, for Metro Transit systems and establish the de facto standard for the industry.
- Development of the Safety System platform based on HollySys' core technologies which can be utilized to develop the ESD (Emergency Shut Down) system (instrumentation and controls installed for the purpose of taking the process, or specific equipment in the process, to a safe state), for large chemical processes or the protection system of turbine generators of power plants. The profit margin of these systems should be several times higher than the conventional Distributed Control Systems.
- Transplant the safety system platform to the signal systems for the main railway transport control systems. The successful transplant of the triple redundancy and the quadruple redundancy system platform to the railway signal interlocking, the automatic train protection system, and the CTC (Central Train Control) systems, high speed train control systems installed along the railway stations, should help HollySys to obtain a leading position over time in this market.
- Application of the SCADA (Supervision Control and Data Acquisition) platform and concept to the information management systems for government uses.
- Development of PLC (Programmable Logic Controller) systems (which are microcomputer-based control devices used to replace relay logic for the purpose of implementing specific functions such as input and output control, logic, timing, counting, regulating control, communication, arithmetic, and data and file manipulation), based on HollySys' core technologies.

HollySys believes that it will have opportunities to expand into growing market sectors by establishing relationships with existing market participants, in some cases acquiring minority or controlling ownership interests in these businesses.

### **Products and Services**

As a leader in China's automation and controls industry, HollySys offers specialized automation solutions (including management and control integrated solutions for process industries, automation solutions for subway and light-rail and railway signaling automation solutions) based on each client's specific requirements. HollySys commits itself to provide reliable, advanced and cost-effective solutions to help customers optimize their processes to achieve higher quality, greater reliability and better productivity and profitability.

HollySys's integrated solutions create value for and improve the competitive strengths of its customers in a number of ways:

- Generate synergy and improve efficiency of its customers through integrating communications, marketing and service functions;
- Utilize its industry and process knowledge to develop customized solutions that improve the efficiency of its customers;
- Provide a software platform (which cannot be sold separately) for the optimization of management operations, which provides real-time automation and information solutions throughout a business; and
- Offer maintenance and training services to its customers, which help to cut costs and improve operating efficiency.

HollySys customizes the floor plans of the solutions based on careful on-site studies, builds design-specific network systems using its advanced Distributed Control Systems technology and proprietary software, and offers manufacturing execution system services to ensure that real-time management control is available to its customers in a streamlined and easy-to-use manner.

Based on its careful research of the demand and requirements of manufacturing industries for information technology, HollySys proposes management and control integrated solutions. The solutions are based on the HOLLiAS (HollySys Integrated Industrial Automation System) platform, which includes features of the fourth generation of Distributed Control Systems and functions of the international mainstream Distributed Control Systems. 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, HollySys can provide customized solutions to meet the application requirements of different industries.

HollySys establishes a project group for each potential customer, which has a team of systems engineers and managers engaged in providing total integrated solutions to its 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.

HollySys' integrated solutions projects involve one or more of the following activities:

- Solution planning. HollySys provides its customers with strategic and tactical reviews of their current operations and future requirements. HollySys does 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 in winning the contract. The planning includes defining client business requirements, developing appropriate hardware and software and selecting preferred technology.
- Solution design. HollySys details the industry specifications and implementation tactics necessary to achieve its customer's objectives. HollySys also considers how the new technology will integrate hardware and software integrated in the solution with the customer 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 its components, developing integration plans and designing of customer-specific system and services applications.
- Solution implementation. HollySys installs the recommended systems to meet its 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. HollySys also emphasizes creating value for its clients by providing high quality tailored services. HollySys' professional, prompt and long-term services include technical services, engineering services to specific industries, application development services and maintenance services. HollySys provides maintenance and technical support in connection with all its 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. HollySys believes that its policy of on-going maintenance and technical support will help foster long-term relationships with its customers and eventually create significant business opportunities.
- Training. HollySys also incorporates customer training and an ongoing service component into its product offerings. HollySys provides technical training for its customers and strategic partners to increase their awareness and knowledge of Distributed Control Systems technologies in the Chinese industrial automation market and to support the operations of its 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.

HollySys believes that its product design and applications that are integrated in the solutions are unmatched among its domestic competitors. It also believes that the sophistication and quality of its products rival those of the western-based industry leaders, while its ability to understand and meet the needs of its Chinese customers gives it a decided advantage over those western competitors. The value of this combination is reflected in its strong revenue and profits growth in recent years.

## Research and Development

As a high-technology company, HollySys' business and long-term development rely highly on its research and development capabilities. The research and development process of HollySys is established based on Capability Maturity Model Integration Level (CMMIL) 2&3 that can be classified into the following seven phases:

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

HollySys uses standard project development life cycle models, including waterfall model, increment model, iterative model and prototype. As a technology leader, HollySys keeps developing and patenting new automation technologies every year. HollySys continually reviews and evaluates technological changes affecting the automation and integrated system industries and invests substantially in application-based research and development. In addition to the research and development personnel, HollySys also employs approximately 40 head engineers who are involved in the design, manufacturing and quality control stages of the production process. HollySys' core technologies achieved from its research and development efforts include:

- Large scale software platform architecture design;
- Proprietary network design and development technologies;
- Safety computer platform design and manufacturing;
- Efficient I/O (Input/Output) signal processing design technology; and
- Embedded system design and manufacturing

HollySys is 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. HollySys currently spends approximately 2-4% of annual revenues on research and development. Because part of its research and development efforts were paid for by government subsidies that aim to encourage research and development efforts of certain enterprises, the amount of research and development spending by HollySys shown on its financial statements (the total amount of spending less the amount of these subsidies) is only a portion of the total spending on research and development. HollySys' recent major research and development focuses include:

- Process Control;
- Nuclear Power Automation System;
- Transportation Automation; and
- Manufacturing Automation.

HollySys' research and development efforts have led to the invention of several proprietary systems in the fields of Distributed Control Systems and transportation automation systems. HollySys' core technologies provide a platform that is designed to enable the rapid and efficient development of HollySys technologies for specific applications that are quickly, efficiently and affordably tailored to particular industries and the needs of its individual customers. Its software development tools enable HollySys to custom program its systems rapidly, allowing HollySys to apply digital technologies that take advantage of the tremendous advances in electronics and information technology to improve quality and reliability while reducing cost. The market for HollySys' products includes not only the continuing large number of factories that are under construction in China's rapidly expanding industrial base, but also

extends to the replacement and upgrading of outdated legacy systems to bring a higher degree of control and efficiency to the automation of processes, delivering increasing benefits to customers that must meet stiffening competition.

### **Intellectual Property Rights**

HollySys relies on a combination of copyright, patent, trademark and other intellectual property laws, nondisclosure agreements and other protective measures to protect its proprietary rights. HollySys also utilizes unpatented proprietary know-how and trade secrets and employs various methods to protect its trade secrets and know-how. As of the end of June 2005, HollySys and its subsidiaries held 15 software copyrights, 39 authorized patents, nine patent applications and 18 registered trademarks.

The earliest of HollySys' software copyrights will expire in 2050. HollySys' invention patents have terms of 20 years (with the first issued patent expiring in 2023), and HollySys' utility patents and design patents have terms of 10 years (with the first issued patent expiring in 2010).

Although HollySys employs a variety of intellectual property in the development and manufacturing of products, HollySys believes that only a few of intellectual property rights are individually critical to its current operations. However, taken as a whole, HollySys believes intellectual property rights are significant and that the loss of all or a substantial portion of such rights could have a material adverse effect on its results of operations. From time to time, HollySys may desire or be required to renew or to obtain licenses from others in order to further develop and manufacture commercially viable products effectively.

HollySys markets its Distributed Control Systems products mainly under the brand name of "HOLLiAS". The brand name has been well-established over the years and is recognized by industry participants as well as the customers to be associated with high quality and reliable products. HollySys has obtained trademark protection for the brand name "HOLLiAS" in the PRC. In addition, HollySys and its subsidiaries have also registered or applied for a series of trademarks including brand names for both HollySys and its products. The trademarks are issues for periods of 10 years (and may be renewed prior to expiration), with the oldest issued trademark expiring in November 2007.

### **Marketing, Sales and Customer Support**

HollySys conducts its operations mainly through offices of Beijing HollySys and Hangzhou HollySys. HollySys' marketing and sales activities cover wide areas of China that supply the vast majority of the demand for automation and control products, systems and services.

Since the HollySys market strategy is to tailor its products to the specific needs of its customers, its sales force includes numerous engineers from a variety of disciplines. The collective expertise of this sales staff of qualified professionals gives HollySys an additional advantage relative to its domestic competitors.

Most products of HollySys are used at the system level and it has adopted a centralized sales process, i.e. direct selling by the headquarters personnel. HollySys also markets and sells its services and products primarily through its direct sales force. The direct sales force is organized into three groups, as follows:

- Department of Region Sales: there are 8 geographic sales regions covering 30 provinces in China. The direct sales professionals provide business consulting, promote pre-sale activity and contact the customer.
- 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 System ("DEH"), air separation and desulphurization.

Currently, the Programmable Logic Controller products are in an early marketing stage, and HollySys is using three contracted distributors and developing more distributors to expand sales of its Programmable Logic Controller products.

HollySys identifies and targets market segments and selects target sales opportunities on a national level, and it also conducts 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. HollySys classifies market segments and target

opportunities on national and regional levels. This classification helps it to determine its 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.

HollySys' market strategy focuses on building strategic cooperative relationship with its customers, educating them about technological developments and reflecting their interests in its services and products. Up to now, its marketing and sales efforts were combined. HollySys employs marketing personnel to conduct market research, to analyze user requirements and to organize marketing communications. The 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.

HollySys actively participates in technology-related conferences and demonstrates its products at trade shows or at exhibitions targeted at its existing and potential customers. Also, HollySys evaluates a range of joint-marketing strategies and programs with its partners in order to take advantage of their strategic relationships and resources.

As of June 30, 2005, HollySys employed 240 direct sales personnel who were assigned to three business areas: railway transportation, nuclear power plant, and distributed control systems. Sales activities are coordinated at the headquarters of Beijing HollySys and Hangzhou HollySys. All sales staff are responsible for implementing the sales policies established at headquarters.

HollySys' sales teams consist of a complementary group of sales personnel and hardware and software engineers. HollySys also makes certain that a member of the sales team possesses significant hands-on, industry-specific experience. This permits the team to do an on-site process analysis that comes from first hand knowledge of the processes being evaluated. This, in turn, makes the design and implementation of upgrades simpler.

This relatively intense effort at the sales stage promotes the success of HollySys in a number of ways, such as the ability to design the system that best meets the needs of the customer and delivering a custom solution instead of an off-the-shelf amalgamation of hardware. By employing a pool of skilled personnel at this early stage, accelerators the design and the subsequent production of a particular customized solution, typically exceeding that of HollySys' competitors. The result is a system that is more effective, efficient and reliable, which in turn leads to a truly satisfied customer.

HollySys has strong industry problem solving capability with a reputation for punctual service and quick response to customers' problems. HollySys also supports its customers by offering field services such as maintenance and training services, which help customers to cut cost and improve operating efficiency.

As noted earlier, HollySys is able to apply a large amount of engineering resources to this and other phases of its businesses because engineering talent in China costs only about 10% to 15% of what it costs in the U.S. and Western Europe.

### **Manufacturing**

HollySys assembles its products from subcomponents provided by others or outsources the production to qualified vendors. HollySys acquires advanced printed circuit board components from high quality suppliers. HollySys' uses a team within its manufacturing management department to coordinate procurement of raw materials and outsourced processing, including procurement of components and standard parts (such as cables and connectors), and outsourced processing of PolyvinylChloride (PVC) coating, shells, and printed circuit boards. Products must go through rigorous tests at HollySys before shipment.

HollySys strictly follows ISO9001 standards during parts outsourcing and manufacturing, system assembly and testing to warrant the quality of the whole system.

### **Competition**

Having proprietary systems and products offers a competitive advantage over domestic Chinese competitors that lack the capabilities of HollySys. However, a number of large multinational companies with extensive resources have been

offering first rate automation systems to Chinese customers since before HollySys existed. Differentiation from its multinational competitors on the basis of product quality is not alone sufficient to give HollySys an advantage over those competitors in the Chinese market. Compared to its competitors, HollySys' competitive advantages include following elements:

- A large, low cost engineering staff that permits HollySys to provide a custom solution to its customers at a lower price and quicker delivery than western companies can supply an off-the-shelf system;

- Providing a one stop solution for customers consisting of a fully integrated system that includes Enterprise Resource Planning, Manufacturing Execution Systems, Distributed Control Systems, Programmable Logic Controls and other dedicated automation equipment;
- Development of core technologies that provide a platform for rapid and efficient adaptation of basic modules to the specific needs of a given customer, which renders the resulting product both more useful and affordable;
- Utilization of engineering professionals in the sales process to help match system capabilities to customer needs and provide the assurance that HollySys can meet those needs;
- An in-depth understanding of local Chinese business capabilities, needs and practices that enables HollySys to design a custom fit for the size, type and level of sophistication of the customer;
- Use of an open architecture in its systems that enables HollySys to integrate them with legacy systems developed by other providers;
- Offering ongoing services, which not only create the opportunity to generate additional revenue, but enable HollySys to troubleshoot installations effectively, help to ensure that maximum benefit is derived from the system, and gives HollySys the ability to identify the need for new products and services that will benefit the customer and generate additional business for HollySys.

*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 staffs due to the high salaries and attendant costs.

One of the HollySys' 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 HollySys 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.* HollySys devotes substantial time and effort to understanding the customer's processes. That knowledge of the customers' businesses helps the engineers to ensure that the systems they design will provide the optimum in benefits for the customers. HollySys maintains this information in an extensive "library" of industry process information that it utilizes 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, HollySys is able to take into account the widely varying degree of sophistication and resources that its Chinese customers possess. The result of this strategy is to broaden its potential customer base and to deliver consistently products that are of value to these customers.

*Integration Services.* Western automation system companies are principally system platform suppliers. The role of integrating the systems into the customer's overall management information system is generally left to independent firms, which are widespread in western countries.

China does not have a large number of systems integration companies to perform this work, as the profitability of these companies has historically been very low. HollySys has bridged that gap by providing a vertically integrated solution to its customers that includes integration of the HollySys 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 HollySys delivers tailored systems, its 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 HollySys, with its labor cost advantages, 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.

HollySys, to a greater extent than its western competitors, understands the full range of needs and capabilities that its Chinese customers possess, and it has designed its business to meet them. As a result, it is 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.

*The Role of Post-Installation Maintenance Services.* Automation systems require regular maintenance to operate within the tight tolerances needed to meet customer requirements. Older, analog systems were well within the capability of many customers to maintain on their own. However, as automation systems shifted to electronic components utilizing custom software and working off of digital signals, their complexity increased and the ability of customers to maintain their systems independently decreased. It is possible for customers to hire specialized personnel with the knowledge to perform system maintenance. However, it is not efficient for them to do so, as their maintenance responsibilities would absorb only a portion of a work week.

HollySys believes that it is unique among automation equipment manufacturers because it offers its customers maintenance services along with its products. HollySys' regional sales and services offices place it within easy reach of a very high proportion of its customer and potential customer base. That means it is possible for a single maintenance technician to cover maintenance calls for many customers each week, making the service more cost-effective than having the customer maintain the systems on its own.

The advantages of offering this service lie not in the revenue that it generates directly, but in the benefits derived from the strengthened relationship with customers. Those benefits include: more effective maintenance and system operation, which leads to increased customer satisfaction; better customer relationships, which improve customer loyalty; and the ability to identify new business opportunities for HollySys as the customer's business evolves.

Another way that HollySys keeps ahead of its competitors is by its pace of development. HOLLiAS is the fourth generation of controller system developed by HollySys, and it took HollySys only a little more than a decade after its first operational system to achieve this breakthrough. HollySys believes that its competitors are frequently hampered by institutional factors that slow the product development process. As a result, their products cannot incorporate the latest advances in electronics.

## **Employees**

HollySys employed approximately 1000 people as of June 30, 2005. HollySys has a large staff of engineering and technical personnel. Approximately 700 of its employees possess an engineering degree, and another 200 are highly skilled technicians. Together they comprise approximately 90% of the total HollySys workforce, a concentration of engineering and technical talent that HollySys does not believe is matched by any of its competitors. HollySys' strong reputation allows it to attract and retain the engineering talent it needs to execute its business strategy. As the prevailing wage for engineers in China is considerably less than the equivalent rates in Western economies, HollySys sees this as a significant competitive advantage.

**Properties**

HollySys owns property at the following principal locations, each of which contains principal administrative offices, sales and marketing offices, research and development facilities, and manufacturing facilities:

<b>Location</b>	<b>Approximate Sq. Meters</b>	<b>Ownership</b>
Beijing	18,000	Owned
Hangzhou	25,000	Owned

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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. HollySys considers all of these facilities to be in a condition suitable for their current uses and to be adequate for HollySys' present needs.

### **Legal Proceedings**

HollySys is not involved in any legal proceedings which are expected to have a significant effect on its business, financial position, results of operations or liquidity, nor is Chardan aware of any proceedings that are pending or threatened which may have a significant effect on its business, financial position, and results of operations or liquidity.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### BUSINESS OVERVIEW

Gifted Time Holdings Limited (the "Company" or "Gifted Time Holdings") is a holding company that owns a 74.11% equity interest in Beijing HollySys Co., Ltd. ("Beijing HollySys") and a 60% direct ownership interest in Hangzhou HollySys Automation Co., Ltd. ("Hangzhou HollySys," and, together with Beijing HollySys and its subsidiary, the "Operating Companies"). In addition, the Company indirectly owns another 29.64% of Hangzhou HollySys by virtue of the fact that Beijing HollySys owns 40% of Hangzhou HollySys, and the Company owns 51.9% of Haotong by virtue of the fact that Beijing HollySys owns 70% of Haotong.

Beijing HollySys was established in September 1996 as a domestic Chinese company based in Beijing China. From inception, it has been engaged in designing, developing and manufacturing automation control systems for customers throughout China. It 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. Beijing HollySys owns 40% of Hangzhou HollySys, and the Company owns the remaining 60%. The operations of Hangzhou HollySys emphasize industrial automation and integrated solutions.

Gifted Time Holdings directly owns 74.11% of the equity interests in Beijing HollySys through various stock consignment agreements entered into with Beijing HollySys stockholders (or the parties to which they have assigned their rights) and 60% of the equity interests in Hangzhou HollySys through share transfer agreements entered into with Team Spirit and OSCAF. In addition, Gifted Time Holdings indirectly owns another 29.64% interest in Hangzhou HollySys by virtue of its 74.11% ownership of Beijing HollySys and the fact that Beijing HollySys owns 40% of Hangzhou HollySys. The terms of the stock consignment agreements are discussed in more detail on page 60 above. Under the stock transfer agreements between Gifted Time Holdings and Team Spirit and OSCAF, Team Spirit and OSCAF, which each respectively owned 30% of the interest in Hangzhou HollySys, transferred their respective 30% equity interest in Hangzhou HollySys to Gifted Time Holdings. As consideration for such transfer, Team Spirit and OSCAF each received 7,966 shares of Gifted Time Holdings' common stock, each representing 15.932% of the total outstanding common stock of Gifted Time Holdings. As a result of that transfer, Hangzhou HollySys received Chinese governmental approval of the share transfer from Team Spirit and OSCAF to Gifted Time Holdings on February 13, 2006. Hangzhou HollySys has received a revised registration certificate as of March 31, 2006 from the Administration Bureau of Industry & Commerce reflecting the change in ownership on March 31, 2006.

Minority interest presents the minority interest (accounting for 25.89% interest) in Beijing HollySys owned by Beijing No.6 Institute Huasheng High-Tech Co., Ltd and Beijing New Technology Industry Development and Services Center where it also covered the minority share of net income (loss) in Hangzhou HollySys in proportion, and the minority interest (accounting for 30% interest) in Haotong which was owned by three native personal (Ms. Liu Qin, Mr. Xu Yue, and Mr. Wang Dongming).

In order to establish market presence in the major marketplaces in China and be geographically closer to HollySys' customers, Beijing HollySys has also invested in several other companies that are engaged in various aspects of the automation industry. As of March 31, 2006, these ownership interests were in the following companies:

- New Huake Electronic Technology Co., Ltd. (37.5%);

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- Beijing Haotong Science and Technology Development Co., Ltd. (“Haotong”) (70%);
  - HollySys Information Technology Co., Ltd. (40%);
- HollySys Zhonghao Automation Engineering Technology Co., Ltd. (“HollySys Zhonghao”) (89.11%);
  - HollySys Electric Technology Co., Ltd. (40%);
    - Beijing TechEnergy Co., Ltd. (50%); and
  - Beijing HollySys Equipment Technology Co., Ltd. (20%).

The operating life of Beijing HollySys and its subsidiaries and affiliates is shown in the table below.

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<b>Company Names</b>	<b>Operating period</b>	<b>Operating life</b>
Beijing HollySys Co., Ltd.	Sep. 25, 1996-Sep. 24, 2026	30
Hangzhou HollySys Automation Co., Ltd.	Sep. 24, 2003-Sep. 23, 2053	50
Beijing HollySys Haotong Science & Technology Development Co., Ltd.	Oct. 26, 2000-Oct. 25, 2020	20
Beijing No. 6 Institute New Huake Electronic Technology Co., Ltd.	Aug. 28, 2001-Aug. 27, 2011	10
Beijing HollySys Electric Tech. Co., Ltd.	June 22, 2000-June 21, 2010	10
Beijing HollySys Information Technology Co., Ltd.	June 25, 2002-June 24, 2022	20
Beijing HollySys Hengye Science & Technology Co., Ltd.	Aug. 15, 2000-Aug. 14, 2030	30
HollySys Equipment Technology Co., Ltd.	Sep. 26, 2005-Sep. 25, 2015	10
Beijing HollySys Zhonghao Automation Engineering Technology Co., Ltd.	July 8, 1999-July 7, 2049	50
Beijing TechEnergy Co., Ltd.	Oct. 18, 2005-Oct. 17, 2025	20

Among the entities presented above, HollySys Zhonghao stopped accepting new contracts in July 2002 and has been engaged in winding down its business activities since then. Currently, the shareholders of HollySys Zhonghao have not reached a clearly defined liquidation plan as a base for reasonable estimation of liquidation loss.

The main channel through which HollySys gets its automation system business is the bidding process. Customers seeking bids propose their requirements and specifications in legal bidding documents and those interested in doing so make a bid on the contract in written form. If HollySys wins the bidding, it gets the integrated contract.

HollySys derives its revenue mainly from the integrated contracts it has won through the bidding process, which accounts for over 90% of the total consolidated revenue. In addition, HollySys also sells spare parts and component products to customers for maintenance and replacement purposes after the completion of 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 HollySys offers 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 so they cannot be sold separately to customers.

The process of fulfilling an integrated contract consists of the following three stages:

1) Solution planning and design. HollySys provides customers with 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, HollySys enters into 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 our 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. Typically, we provide one-year warranty, which begins to run from the date that the customer signs the acceptance document.

Because of the nature of customized integrated contracts, the customers do not have the rights to return the products we deliver, provided they conform and perform to the customer's specification. Before HollySys delivers its products to a customer's site, HollySys performs an internal test to see if the automation system works as intended. After installing the products on a customer's site, the problem will be solved during the real trail runs. Until the testing results have been satisfied, a customer will sign a customer acceptance document and date this document as the warranty period starts counting on that date. Due to the nature of this process, many companies in automation systems business generally do not carry product liability insurance.

The size of an integrated contract is driven by a customer's needs in terms of the amount of equipment needed. The size of an integrated contract drives the price of an integrated contract. The more contracts HollySys wins, the more revenues HollySys will earn. Generally speaking, the bigger about the size of an integrated contract, the bigger the revenue of an integrated contract. The number of integrated contract HollySys has won is an indicator of backlog. Because certain contracts will require working period longer than one year, the best way to measure the contract revenue realized is to use the percentage-of-completion method. Ultimately, HollySys's revenue stream will be driven by the average price of an integrated contract and how many integrated contracts have started in each reporting period.

Backlog presents the amount of unrealized revenue to be earned by the Company from the contracts Hollysys won. Accordingly, the increase or decrease of the new contracts Hollysys has won will have future impacts on our revenue streams. In addition, the change of schedule from Hollysys' customers will have impact on the Company's revenue stream as customers may change their requested delivery schedule resulting in a delay of the expected delivery. Due to the delay of delivery schedule, the time of inspection, installment, trial run and customer acceptance will be delayed accordingly, all of which will have impact on the Company's revenue recognition. If the delay of delivering the specified automation systems was a result of the Company's inability to deliver the system on a timely basis, it will be responsible for this delay according to the terms specified in respective integrated contracts.

The following table sets forth the information regarding the contracts Hollysys won during the fiscal years and backlog at the dates indicated:

	<b>For Fiscal years Ended June 30,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Number of new contracts won during the year	372	599	702
Total amount of new contracts (mm)	\$ 40.84	\$ 88.29	\$ 90.06
Average price per contract	\$ 109,777	\$ 147,398	\$ 128,286
	<b>As of June 30,</b>		
<b>Backlog Situation:</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Contracts newly entered and unfinished (mm)	\$ 16.80	\$ 56.92	\$ 46.95
Contracts started in the prior year and unfinished (mm)	\$ 21.42	\$ 15.43	\$ 23.98
Total amount of backlog (mm)	\$ 38.22	\$ 72.35	\$ 70.93

As of June 30, 2005, as a growing company, HollySys and its subsidiaries have achieved significant process in the past three years. HollySys has been able to convert its increased revenues into higher profits. The Company generated net income of \$13.70 million, \$4.74 million, and \$2.23 million for the fiscal years ended June 30, 2005, 2004 and 2003, respectively. During the nine months ended March 31, 2005 and 2006, the Company achieved a net income of \$10.10 million and \$10.11 million, respectively.

Regarding the total consolidated revenues, the Company achieved \$61.26 million for the nine months ended March 31, 2006, compared to \$56.35 million for the same period of the prior year. Total revenues grew 47.5% from \$35.99 in fiscal 2003 to \$53.07 million in fiscal 2004, followed by a growth of 49.9% to \$79.57 million in fiscal 2005.

Hollysys' philosophy emphasizes operating a highly efficient and profitable business enterprise that generates value for its customers, employees, and shareholders.

## **CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of the Company's financial condition presented in this section are based upon the Company's consolidated financial statements, which have been prepared in accordance with the generally accepted

accounting principles in the United States. During the preparation of the consolidated financial statements, the Company is required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates and judgments, including those related to sales, returns, pricing concessions, bad debts, inventories, investments, fixed assets, intangible assets, income taxes and other contingencies. The Company bases its estimates on historical experience and on various other assumptions that it believes are reasonable under current conditions. Actual results may differ from these estimates under different assumptions or conditions.

In response to the SEC's Release No. 33-8040, "Cautionary Advice Regarding Disclosure about Critical Accounting Policy," the Company has identified the most critical accounting policies upon which its financial status depends. It determined that those critical accounting policies are related to the use of estimates, inventory valuation, revenue recognition, income tax and impairment of intangibles and other long-lived assets. These accounting policies are discussed in the relevant sections in this management's discussion and analysis, including the Recently Issued Accounting Pronouncements discussed below.

### **Revenue recognition**

Revenues, primarily generated from designing, building, and delivering customized integrated industrial automation systems and providing relevant solutions, are recognized over the contract term 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 Operating Companies and customers. Performance of these contracts often will extend over long periods, and the right to receive payments depends on the performance by the Operating Companies in accordance with these contractual agreements. 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 compared to the expected total costs for the contracts. Revisions in 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 unbilled receivables and included in accounts receivable. 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.

Revenue generated from sales of spare parts for maintenance and replacement are 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 collectibility is reasonably assured.

### **Accounts receivable, other receivables and concentration of credit risk**

During the normal course of business, the Operating Companies extend unsecured credit to their customers, as they do not require collateral from customers for payment of their obligations. The normal credit terms allow 90 to 120 days for payment. The Operating Companies maintain cash accounts at credit worthy financial institutions. They regularly evaluate and monitor the creditworthiness of each customer on a case-by-case basis. At the end of each period, allowance for doubtful accounts of billed accounts receivable is accrued using the age analysis method. The Company includes any account balances that are determined to be uncollectible in the allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Other receivables include deposits required to be submitted with bids on contracts. Contract bidding service providers will deduct a portion of these deposits as service fee if the Operating Companies win a contract, and the balance is returned to them after the bidding process ends. If they do not win a contract, the full amount of the deposit is returned to them at the conclusion of the bidding process.

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. Revenue in excess of billings on the contracts is recorded as unbilled receivables. The Company provides a bad debt provision based on the age of receivables and factors surrounding the credit risk of specific customers. Based on historical experience, the bad debt allowances are provided using a percentage method as follows.

	<b>Within 1 year</b>	<b>1-2 years</b>	<b>2-3 years</b>	<b>3-5 years</b>	<b>Above 5 years</b>
Percentage	2%	5%	15%	50%	100%

The Company also provides additional bad debt provisions for an individual customer if there is a deterioration of the customer's creditability and actual defaults are higher than the historical experience.

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Historically, HollySys had a few actual bad debts occur during its operation. Based on the information available to management and above the policy for allowance of bad debt, it believes that the allowance for doubtful accounts as of June 30, 2003, 2004 and 2005 and March 31, 2006 was adequate, respectively.

### **Inventories**

Inventories are composed of raw materials and low value consumables, work-in-progress and finished goods. Inventories are stated at the lower of cost or market based on the weighted average method. The work-in-progress represents the costs of projects which have been initiated in accordance with specific contracts and are not yet complete. 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.

### **Impairment of long-lived assets**

The Company reviews long-lived assets for impairment when certain indicators are present that suggest the carrying amount may not be recoverable. This review process primarily focuses on other intangible assets from business acquisitions and property, plant and equipment. Factors considered include the under performance of a business compared to expectations and shortened useful lives due to planned changes in the use of the assets. Recoverability is determined by comparing the carrying amount of long-lived assets to estimated future discounted cash flows. If future discounted cash flows are less than the carrying amount of the long-lived assets, an impairment charge would be recognized for the excess of the carrying amount over fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. Additionally, in the case of assets that will continue to be used in future periods, a shortened life may be utilized, if appropriate, resulting in accelerated amortization or depreciation based upon the expected net realizable value of the asset at the date the asset will no longer be utilized by us. Actual results may vary from estimates due to, among other things, differences in operating results, shorter asset useful lives and lower market values.

### **Income taxes**

The Company recognizes deferred tax liabilities and assets 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.

The Company assesses the likelihood that its deferred tax assets can be recovered. If recovery is not likely, the provision for taxes must be increased by recording a reserve in the form of a valuation allowance for the deferred tax assets that are estimated not to be ultimately recoverable. In this process, certain relevant criteria are evaluated, including the existence of deferred tax liabilities that will absorb deferred tax assets, the taxable income that can be used to absorb net operating losses and credit carry-backs, and taxable income in future years. The Company's judgment regarding future profitability may change due to future market conditions, changes in tax laws and other factors. These changes, if any, may require material adjustments to these deferred tax assets and an accompanying reduction or increase in net income in the period when such determinations are made. In addition to the risks described above, the effective tax rate is based on current enacted tax law. Significant changes during the year in enacted tax law could affect these estimates.

## **RESULTS OF OPERATIONS**

**Comparison of Nine Months Ended March 31, 2006 and 2005**

*Operating revenues*

For the nine months ended March 31, 2006, total revenues amounted to \$61.26 million, an increase by \$4.91 million, compared to \$56.35 million for the same period of the prior year, representing an 8.7% increase. This growth rate was lower than the preceding periods mainly due to the fact that the execution of some projects was delayed based on the revised schedules of the Company's customers. Delays in integrated solution projects are not unusual. The Company does not believe that the delay in execution of these contracts is an indication that it will not complete the work. The majority of the Company's integrated systems contracts are performed over a period of months, and sometimes take more than a year.

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Of the total revenue of \$61.26 million, the integrated contract revenue accounted for \$57.77 million, an increase by \$3.62 million, compared to \$54.15 million for the same period of the prior year, representing a 6.7% increase. The increase was primarily due to a greater number of integrated contracts being performed during the nine months ended March 31, 2006. There were 1,404 contracts being performed during that period compared to 1,119 for the same period of the prior year, a 25.5% increase.

Of the \$61.26 million of total revenues, approximately \$3.50 million was related to product revenue, an increase of approximately \$1.29 million over the \$2.21 million in product revenue for the same period of the prior year, a 58.5% increase. The growth was mainly due to the increased demand for the Company's equipment for customers' maintenance and replacement purposes during this period.

#### *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 Company's revenue backlog growth rate was higher than preceding periods. The backlog as of March 31, 2006 amounted to \$85.58 million, representing an increase of 37.4%, compared to \$62.30 million as of March 31, 2005.

Of the total backlog, the aggregate contract prices of the new contracts signed in the current period was \$60.06 million and the carry forward amount of the outstanding contracts from the prior year was \$25.52 million, while the total backlog at March 31, 2005 comprised of \$26.38 million from the contracts unstarted, started and unfinished and \$35.92 million from contracts started in the prior year and unfinished, respectively.

#### *Cost of revenues*

The total cost of revenues amounted to \$40.49 million, an increase by \$2.16 million compared to \$38.33 million for the same period of the prior year, a 5.6% increase. The increase was consistent with the increase in total revenue.

Cost of revenues can be divided into cost of integrated contracts and cost of products sold, in line with the categories of revenues. The components of cost of revenues shifted somewhat, as the cost of integrated contract revenue decreased from 97.5% of the total cost of revenues for the prior period to 95.6% for the nine months ended March 31, 2006.

The cost of integrated contract revenue consists mainly of costs for designing, building and delivering customized automation systems and providing solutions to customers (including material, components, equipment purchased and internally produced products, and labor and other manufacturing expenses). The total cost of integrated contracts was \$38.69 million, an increase of \$1.31 million compared to \$37.38 million for the same period in the prior year, a 3.5% increase. This was consistent with the increased number of integrated contracts being performed. As a percentage of cost of integrated contract revenue, labor cost accounted for 6.8% compared to 8.7% in the same period the prior year, cost of equipment accounted for 72.2% compared to 70.7% in the same period the prior year, and other contract execution expenses accounted for 21.0%, which increased slightly from 20.6% in the same period the prior year. As a percentage of integrated contract revenue, labor cost accounted for 4.6% compared to 6.0% in the same period the prior year, cost of equipment accounted for 48.4% compared to 48.8% in the same period the prior year and other contract execution expenses accounted for 14.0%, which slightly decreased from 14.2% in the same period the prior year. Due to the combined impact of these changes in cost of integrated contract revenue, gross margin for integrated contracts increased from 31.0% for the nine months ended March 31, 2005 to 33.0% for the nine months ended March 31, 2006, reflecting the realization of some economies of scale as our business continued to expand.

Cost of products sold was \$1.80 million, an increase of \$849,000 compared to \$948,000 for the same period of the prior year. The increase in cost of products sold was due to the fact that, in order to better satisfy customers' needs in the current period, the Company purchased a greater portion of products sold from outside vendors at higher prices relative to internally produced equipment, more of which was sold in the same period last year. Consequently, the gross margin for product sales in the same period of the prior year was higher.

*Gross margin*

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As a percentage of total revenues, the overall gross margin was 33.9% for the nine months ended March 31, 2006 compared to 32.0% for the same period in the prior year.

The gross margin for integrated contracts was 33.0% for the nine months ended March 31, 2006 compared to 31.0% for the same period of the prior year. The Company's ability to improve its gross margins was a result of adopting some new cost-saving measures, such as centralized procurement with volume discounts and rebates, a more efficient deployment of its work force and improved project management capabilities. The Company intends to continue to strengthen its cost-saving measures. Moreover, it has established a new price quotation system with pricing guidelines that are adaptable to the characteristics of diverse industries and regions to maximize the prices it can obtain in order to improve its gross profit.

#### *Operating expenses*

#### *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 \$4.76 million for the nine months ended March 31, 2006, an increase of 13.0%, or roughly \$549,000, compared to approximately \$4.21 million for the same period of the prior year. Of the total increase, \$348,000 was related to payroll expense of sales personnel, \$79,000 was for travel expense, \$59,000 was for office rental, and \$111,000 was for office expenses, including telephone and other utilities, and office supplies, and all of which was offset by the decrease of \$48,000 in advertising expenses for the nine months ended March 31, 2006, all compared to the same period of the prior year. As a percentage of total revenues, selling expenses accounted for 7.8% and 7.5% for the nine months ended March 31, 2006 and 2005, respectively, a slight increase. 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 financial department, information systems department and human resources department. The legal and accounting expenses associated with the efforts of HollySys to enter into a business combination with Chardan are also a component of general and administrative expenses.

General and administrative expenses amounted to approximately \$5.28 million for the nine months ended March 31, 2006, an increase of roughly \$1.55 million compared to approximately \$3.74 million for the same period of the prior year, representing an increase of 41.4%. The increase in general and administrative expenses was the result of several factors. First, the expenses connected with the efforts to become listed in a stock exchange outside China caused us to incur \$900,000 in professional service fees, such as fees charged by lawyers and auditors, during this period, while there were no such expenses during the same period the prior year. Second, an increase in compensation paid to non-sales-related employees of \$426,000 occurred. Third, travel expenses increased by \$166,000. Fourth, an increase in guarantee expenses paid to assurance companies increased by \$151,000. Fifth, our bad debt provision increased \$136,000. The above increases were offset by decreases in office expenses (such as supplies, copying expenses, mailing fees, and utilities) of \$215,000 and a decrease in depreciation expenses of \$19,000. As a result of the above net increases, general and administrative expense accounted for 8.6% versus 6.6% of total revenues for the nine months ended March 31, 2006 and 2005, respectively.

#### *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. The nature of our business entitles us to receive governmental subsidies to support our research and development activities. In our financial statements, we present our research and development expenses as a net figure, which is the amount we spent on research and development less the amount of government subsidies that we received for research and development.

Research and development expenses were presented on the statement of income as \$102,000 for the nine months ended March 31, 2006 compared to zero in the same period of the prior year. This was due to the fact that subsidy income received from the government increased to \$4.35 million from \$3.29 million for the nine-month periods ended March 31, 2006 and 2005, respectively. This subsidy income was offset against actual research and development expenses of \$1.66 million and \$1.19 million for the nine-month periods ended March 31, 2006 and 2005, respectively.

*Income from operations*

Income from operations increased by approximately \$542,000, or 5.4%, from \$10.07 million for the nine months ended March 31, 2005 to \$10.61 million for the nine months ended March 31, 2006, as a result of the following increases: \$4.91 million in total revenues, \$2.16 million in cost of revenues, \$549,000 in selling expenses and \$1.55 million in general and administrative expenses. Therefore, as a percentage of total revenue, the operating income for the nine months ended March 31, 2006 was 17.3% compared to 17.9% for the same period the prior year, a slight decrease. The decrease as a percentage of total revenues was due mainly to the increase in general and administrative expenses which were contributed by the increase of professional service fees connected with the Company's efforts to become listed on a stock exchange outside China.

*Interest expenses, net*

For the nine months ended March 31, 2006, net interest expenses increased by \$410,000, or 98.8%, from \$415,000 for the same period of the prior year to \$824,000. The increase in interest expenses was mainly due to the fact that the Company received specified governmental subsidies of approximately \$242,000 for the purpose of offsetting interest expense for the period ended March 31, 2005 that it did not receive in the current period. In addition, the Company's outstanding bank loans especially short-term bank loans in the nine months ended March 31, 2006 were higher than the outstanding bank loans during the same period of the prior year, which increased interest expense from \$480,000 to \$951,000 for the nine months ended March 31, 2005 and 2006, respectively. Also, the Company received \$127,000 of interest income for the nine months ended March 31, 2006, compared to \$66,000 in the same period the prior year. As a percentage of total revenues, the net interest expense for the nine months ended March 31, 2006 was 1.3% compared to 0.7% for the same period of the prior year.

*Other income (expenses), net*

Other income (expense) consists of miscellaneous income from non-operating activities. For the nine months ended March 31, 2006, other net income (expenses) decreased by \$164,000, or 140.7%, from \$116,000 for the same period of the prior year to \$47,000 (negative). The decrease was mainly due to the fact that Beijing HollySys sold some technology to another subsidiary and thus incurred related business taxes and urban construction and maintenance fees. Overall, the change in other income (expense) was immaterial to the Company's financial performance for the nine months ended March 31, 2006 compared with the same period for fiscal 2005.

*Subsidy income*

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, Haotong and Hangzhou HollySys all receive 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. Value added tax refunds recognized for supporting research and development efforts were first offset against research and development expenses, and the remaining balance, if any, together with other subsidies, was recognized as subsidy income in accordance with internationally prevailing practice.

Subsidy income received from the government for the nine months ended March 31, 2006 amounted to \$4.35 million, compared to \$3.29 million for the nine months ended March 31, 2005. Proceeds from subsidies used to offset actual research and development expenses amounted to \$1.66 million and \$1.19 million for the nine-month periods ended March 31, 2006 and 2005, respectively. Also, approximately \$242,000 of financial subsidies from the government was used to offset interest expenses incurred for the same period of the prior year. The remaining amounts of subsidy income of \$2.69 million and \$1.86 million for the nine-month periods ended March 31, 2006 and 2005, respectively, were presented as a separate line item on the statement of income.

*Income tax provision*

For the nine months ended March 31, 2006, the Company's income tax provision was \$784,000 for financial reporting purposes, whereas there was an income tax provision of \$267,000 for the same period of the prior year. This change was due mainly to the following factors: Beijing HollySys had an income tax provision of approximately \$92,000 for the nine months ended March 31, 2006 (as its taxable income decreased) compared to \$240,000 for the same period of the prior fiscal year. Haotong had an income tax provision of approximately \$41,000 (as its taxable income increased) for the nine months ended March 31, 2006 compared to \$27,000 for the same period of the prior fiscal year. Hangzhou HollySys had income of approximately \$12.01 million before income tax for the nine months ended March 31, 2006 compared to \$8.01 million for the same period of the prior fiscal year. However, Hangzhou HollySys was under 100% exemption from income taxes for the nine months ended March 31, 2005, while it is entitled to receive only a 50% exemption from income tax for three calendar years starting beginning Jan 1, 2006. Therefore, the income tax of Hangzhou HollySys was \$651,000 for the nine months ended March 31, 2006, compared to zero for the same period of the prior fiscal year.

*Minority interest*

The minority interest of the Company includes other parties' interests in Beijing HollySys and Haotong. The ownership interests of minorities in these two Operating entities were 25.89% and 30%, respectively.

The minority interest for the nine months ended March 31, 2006 was approximately \$2.09 million, an increase by \$107,000 compared to \$1.98 million for the same period of the prior year. The minority interest percentage in Beijing HollySys and Haotong did not change during the nine months ended March 31, 2006. The increase was attributable to the increase in net income of Beijing HollySys and Haotong which led to the increase in minority interests of \$66,000 and \$41,000, respectively, for the nine months ended March 31, 2006 compared with the same period in fiscal 2005.

*Net income*

For the nine months ended March 31, 2006, the Company's net income amounted to \$10.10 million after deducting the portion attributed to the minority interest, a decrease by \$8,000 compared to \$10.11 million for the same period of the prior year, or 0.08% (negative). This decrease was attributable primarily to the increase in general and administrative expenses and income tax provision from Hangzhou HollySys, which entered a three-year period under a 50% exemption of income tax starting from Jan 1, 2006, offset by the increased revenue and operating income.

**Comparison of Fiscal Years Ended June 30, 2005 and 2004**

*Operating revenues*

For the fiscal year ended June 30, 2005, the Company's total revenues amounted to \$79.57 million, representing an increase of \$26.50 million, over revenues of \$53.07 million for fiscal 2004, representing a 49.9% increase, of which integrated contract revenue accounted for \$75.03 million, an increase of \$23.80 million compared to \$51.22 million for the prior year, a 46.5% increase. The increase was primarily due to a greater number of integrated contracts being performed during fiscal 2005. During 2005, the Operating Companies performed on 1,514 contracts compared to 967 in the prior year. Of the \$79.57 million of total revenues, approximately \$4.55 million was derived from sales of spare parts, an increase of approximately \$2.70 million compared to \$1.85 million in the prior year, a 145.7% increase. The growth was mainly due to the increased demand from customers for the Company's equipment for maintenance and replacement in fiscal 2005.

*Revenue backlog*

As of June 30, 2005, the total amount of backlog was \$70.93 million, decreased slightly by 2.0% from \$ 72.35 million in fiscal 2004, of which contracts unstarted, started and unfinished in the current period was \$46.95 million and carry forward amount of the outstanding contracts from the prior year was \$23.98 million. In addition, the number of new contracts won in the current period was 702, with a total contract value of \$90.06 million, a 2.0% increase from \$88.29 million for the same period of the prior year.

*Cost of revenues*

The total cost of revenues amounted to \$54.68 million, an increase of \$16.78 million compared to \$37.91 million in the prior year, a 44.3% increase. The increase was due mainly to the increase in cost of integrated contract revenue. The components of cost of revenues changed as cost of integrated contract revenue decreased from 99.1% of total cost of revenues in fiscal 2004 to 95.4% in fiscal 2005.

The total cost of integrated contracts was \$52.16 million, an increase of \$14.59 million compared to \$37.57 million in the prior year, a 38.9% increase. This growth in cost of revenues was in line with the overall increase in revenues

generated by integrated contracts. As a percentage of cost of integrated contract revenue, labor cost accounted for 6.4% compared to 6.6% for the prior year, cost of equipment accounted for 70.3% compared to 70.4% for the prior year and other contract execution expenses accounted for 23.3% which slightly increased from 22.9% for the prior year. As a percentage of integrated contract revenue, labor cost accounted for 4.4% compared to 4.9% for the prior year, cost of equipment accounted for 48.9% compared to 51.6% for the prior year and other contract execution expenses accounted for 16.2% which decreased from 16.8% for the prior year. Due to the combined impact of these changes in cost of integrated contract revenue, gross margin for integrated contracts increased from 26.7% in fiscal 2004 to 30.5% in fiscal 2005.

For fiscal 2005, cost of products sold was \$2.52 million, an increase of \$2.18 million compared to \$338,000 in the prior year, representing a 644.8% increase. The increase in cost of products sold was due to the fact that the Company purchased and resold a much larger share of those products from outside vendors in fiscal 2005 compared with fiscal 2004, when it made many of those components internally. As a result, margins on those product sales in fiscal 2005 were significantly smaller.

#### *Gross margin*

As a percentage of total revenues, the overall gross margin was 31.3% for the fiscal year ended June 30, 2005, compared with 28.6% in the prior year.

The gross margin for integrated contract was 30.5% for fiscal 2005 compared to 26.7% for fiscal 2004. The improvement in margins is attributed to the increase in contract pricing, the adoption of various cost-saving measures, such as centralized procurement with volume discounts and rebates, a more efficient deployment of the work force and improved project management capabilities.

#### *Operating expenses*

##### *Selling expenses*

Selling expenses were \$5.65 million for fiscal 2005, an increase of 24.9% or \$1.12 million compared to \$4.52 million for fiscal 2004. Of the increase of \$1.12 million, \$396,000 was related to payroll and employment benefits for sales personnel, \$231,000 was for traveling expenses, \$195,000 for office supplies and utilities, \$117,000 was for entertainment expenses, \$84,000 was for advertisement expenses, \$71,000 was for bidding fees, \$16,000 was for office leasing and \$14,000 was for depreciation of fixed assets in fiscal year 2005, compared to the same categories of expenses for the prior year. However, as a percentage of total revenues, the selling expense accounted for 7.1% and 8.5% for the fiscal years ended June 30, 2005 and 2004, respectively. The Company has established guidelines to monitor and evaluate sales performance in different industries and regions to control selling expenses. The decrease in selling expenses as a percentage of total revenues meant that its selling efficiency had improved compared to the prior year.

##### *General and administrative expenses*

General and administrative expenses amounted to \$5.14 million for fiscal 2005, an increase of \$2.46 million compared to \$2.68 million for fiscal 2004, an increase of 91.8%. The increase was mainly attributable to the following factors: first, the increased compensation for non-sales-related employees by \$1.86 million, which mainly resulted from the increased bonuses distributed and increased staff welfare fund provided by Hangzhou HollySys as required by the foreign investment enterprise laws in China; second, an increase in office expenses (such as paper, copying expenses, mailing fees, and utilities) by \$308,000; third, an increase in guarantee expenses paid to assurance companies by \$211,000; fourth, an increase in depreciation expenses by \$61,000; and an increase in bad debt provision by \$17,000. As a percentage of total revenues, general and administrative expense increased slightly, accounting for 6.5% and 5.1% for the years ended June 30, 2005 and 2004, respectively.

##### *Research and development expenses*

Research and development expenses were \$202,000 and \$383,000 for fiscal 2005 and 2004, respectively. These amounts reflect the fact that subsidy income received from the government of \$3.54 million and \$1.57 million for fiscal 2005 and 2004, respectively, was used as a partial offset against research and development expenses. Actual research and development expenses amounted to \$1.22 million and \$1.95 million for fiscal 2005 and fiscal 2004, respectively.

*Income from operations*

Income from operations increased approximately \$6.44 million, or 86.7%, from \$7.43 million in fiscal 2004 to \$13.88 million in fiscal 2005. The increase was driven primarily by the following facts: increase of \$26.50 million in total revenues, offsetting the increase of \$15.74 million in cost of revenues, the increase of \$2.16 million in selling expenses and the increase of \$2.46 million in general and administrative expenses. As a percentage of total revenues, the operating income for fiscal 2005 was 17.4% compared to 14.0% for the prior year. The increase as a percentage of total revenues was mainly due to a decrease in cost of revenue due to implementation of various cost-cutting measures, resulting in improved gross margins from 28.6% to 31.3% in fiscal 2005.

*Interest expenses, net*

Approximately \$242,000 of governmental subsidy brought the net interest expenses down to \$556,000 from an actual amount of \$889,000 for the fiscal year ended June 30, 2005. Compared to the prior year, the actual interest expense decreased by \$4,000, from \$889,000 to \$895,000 in fiscal 2005. The decrease was primarily due to the fact that the repayment of \$4.59 million in long-term bank loans occurred in fiscal 2005, although an additional \$3.02 million of short-term loans were taken down in fiscal 2005. The lower interest rate associated with those short-term loans helped to reduce the interest expense.

*Other income (expenses), net*

Net other income (expenses) amounted to \$195,000 in fiscal 2005 compared to \$32,000 in the prior year. The increase was due mainly to the income from disposing inventory. Overall, the change in other income (expense) was immaterial to the Company's financial performance for fiscal 2005 and fiscal 2004.

*Subsidy income*

Subsidy income received from the government in fiscal 2005 amounted to \$3.55 million compared to \$1.57 million in fiscal 2004. The Company used these subsidies to offset actual research and development expenses by approximately \$1.02 million in fiscal 2005, compared to \$1.56 million in fiscal 2004. Also, approximately \$242,000 of financial subsidies from the government was used to offset the interest expenses incurred in fiscal 2005. The remaining amounts of subsidy income of \$2.29 million and approximately \$3,000 in fiscal 2005 and 2004, respectively, were presented as a separate line item on the statement of income.

*Income tax expenses*

For the fiscal year ended June 30, 2005, the Company's income taxes provision was \$401,000, compared with an income tax provision of \$948,000 in the prior year. This change was due to the difference in revenue recognition timing for financial reporting and income tax purposes. In addition, the income tax provision took place principally in connection with the Beijing location, as Beijing HollySys and Haotong are subject to a preferential income tax rate at 15% and 7.5%, respectively, whereas Hangzhou HollySys was exempt from income taxes for both periods.

The effective tax rate decreased from 14.0% in fiscal 2004 to 2.0% in fiscal 2005, which was mainly due to benefits given to Hangzhou HollySys under preferential income tax policies. Income before income taxes increased from \$6.72 million in fiscal 2004 to \$16.47 million in fiscal 2005, a \$9.75 million increase. The increase was mainly attributable to the fact that income before income taxes of Hangzhou HollySys increased significantly from \$2.85 million in the prior year to \$11.97 million in fiscal 2005. In addition, Hangzhou HollySys was still exempt from taxation in fiscal 2005. Therefore, the income tax rate reduction increased from 14.9% to 24.1% when comparing fiscal 2004 to fiscal 2005.

*Minority interest*

The minority interest increased approximately \$1.33 million, from \$1.04 million for the prior year to \$2.37 million for fiscal 2005. Of the \$1.33 million of increase, approximately \$1.2 million was attributable to Beijing HollySys and roughly \$130,000 to Haotong.

*Net income*

For fiscal 2005, the Company's net income amounted to \$13.70 million, an increase of \$8.97 million compared to \$4.74 million in the prior year, a 189.4% increase. This increase was attributable primarily to the increase in revenues

and implementation of effective cost-control measures; increase in government subsidies recognized and decrease in income tax provision.

**Comparison of Fiscal Year Ended June 30, 2004 and 2003**

*Operating revenues*

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For the fiscal year ended June 30, 2004, the Company's total revenues amounted to \$53.07 million, representing an increase of \$17.09 million over revenues of \$35.99 million in fiscal 2003, representing a 47.5% increase, of which integrated contract revenue accounted for \$51.22 million, an increase of \$18.30 million compared to \$32.93 million for the prior year, a 55.6% increase. The increase was due primarily to a greater number of integrated contracts being performed for fiscal 2004; the Company performed 967 contracts in fiscal 2004 compared to 645 in fiscal 2003, a 49.9% increase.

Of the \$53.07 million of total revenues, approximately \$1.85 million was derived from sales of spare parts, a decrease of approximately \$1.21 million compared to \$3.06 million in the prior year, a 39.5% decrease. This decrease was the result of the fact that the Company focused increasingly on sales of integrated systems, of which products are a component part, rather than on the sales of products alone.

#### *Revenue backlog*

As of June 30, 2004, the total amount of backlog was \$72.35 million, increased by 89.3% from \$38.22 million in fiscal 2003, of which unperformed amount of new contracts signed in the current period was \$56.92 million and carry forward amount of the outstanding contracts from the prior year was \$15.43 million. In addition, the number of new contracts in the current period was 599, with a total contract value of \$88.29 million, a 116.2% increase from \$40.84 million for the same period of the prior year.

#### *Cost of revenues*

The total cost of revenues amounted to \$37.91 million, an increase by \$12.03 million compared to \$25.88 million for the prior year, representing a 46.5% increase. The increase was due to the increase in integrated contract revenue. The components of cost of revenues changed as cost of integrated contract revenue increased from 94.1% of total cost of revenues in fiscal 2003 to 99.1% in fiscal 2004.

The total cost of integrated contracts was \$37.57 million, an increase of \$13.22 million compared to \$24.35 million in the prior year, representing a 54.3% increase, generally consistent with the increase in integrated contract revenue. As a percentage of cost of integrated contract revenue, labor cost accounted for 4.9% compared to 1.5% in the prior year, cost of equipment accounted for 51.6% compared to 51.8% in the prior year, and other contract execution expenses accounted for 16.8% compared to 20.6% in the prior year. As a percentage of integrated contract revenue, labor cost accounted for 5.2% compared to 5.1% in the prior year, cost of equipment accounted for 48.2% compared to 47.0% in the prior year, and other contract execution expenses accounted for 18.0% for both fiscal years. Due to the combined impact of these changes in cost of integrated contract revenue, gross margins for integrated contracts increased from 26.1% in fiscal 2003 to 26.7% in fiscal 2004.

Cost of products sold was \$338,000, a decrease of \$1.19 million compared to \$1.53 million in the prior year, a 77.9% decrease. The decrease in cost of products sold was due to the decrease in product sales revenue. In fiscal 2004, the Company focused on assembling products into units, which increased the value added by it. However, doing so ultimately reduced its total product sales revenue because these units were customized, generating good gross margins although at lower volumes, compared with the total product sales revenue for fiscal 2003, when it purchased most of the products from outside vendors for resale. As a result, the Company achieved significantly greater margins of 81.7% from product sales in fiscal 2004, compared to 49.9% in fiscal 2003.

#### *Gross margin*

As a percentage of total net revenues, the overall gross margin was 28.6% for the fiscal year ended June 30, 2004, compared with 28.1% in the prior year.

The gross margin for integrated contracts was 26.7% for fiscal 2004 compared to 26.1% for fiscal 2003. The slight increase from the prior year was attributed to the use of more aggressive pricing in bids in order to secure additional orders and build up the number of contracts won, a practice which held margins in line with the prior year.

*Operating expenses*

*Selling expenses*

Selling expense was \$4.52 million for fiscal 2004, an increase of 51.0%, or \$1.53 million, compared to \$3.00 million for fiscal 2003. Of the increase of \$1.53 million, \$477,000 was attributed to payroll and employment benefits for sales personnel, \$468,000 was related to office supplies and utilities, \$259,000 was for entertainment expenses, \$152,000 was for traveling expenses, \$85,000 for office leasing, \$31,000 was for depreciation of fixed assets, \$50,000 was for bidding fees and \$5,000 was for advertisement expenses in fiscal year 2004, compared to the prior year. As a percentage of total revenues, selling expense accounted for 8.5% and 8.3% for fiscal 2004 and 2003, respectively. The Company established guidelines to monitor and evaluate sales performance in different industries and regions to control selling expenses.

*General and administrative expenses*

General and administrative expenses amounted to \$2.68 million for fiscal 2004, compared to \$2.61 million for fiscal 2003, representing an increase of just 2.5%. The increase of \$65,000 was mainly attributable to the following factors: first, the increased compensation for non-sales-related employees by \$135,000; second, an increase in bad debt provision by \$94,000; third, an increase in guarantee expenses paid to assurance companies by \$59,000; fourth, a decrease in office expenses (such as paper, copying expenses, mailing fees, water and electricity) by \$190,000; and finally, an decrease in depreciation expenses by \$33,000. As a percentage of total revenue, general and administrative expenses accounted for 5.1% and 7.3% for fiscal 2004 and 2003, respectively. The Company was able to avoid increases in these expenses despite the Company's increase in overall revenues principally as the result of efficiency improvements.

*Research and development expenses*

Research and development expenses amounted to \$383,000 and \$346,000 for fiscal 2004 and 2003, respectively. This was due to the fact that subsidy income received from the government of \$1.57 million for fiscal 2004 and \$1.12 million for fiscal 2003, respectively, partially offset research and development expenses. Actual research and development expenses amounted to \$1.95 million and \$827,000 for fiscal 2004 and fiscal 2003, respectively.

*Income from operations*

Income from operations increased approximately \$3.92 million, or 111.4%, from \$3.52 million in fiscal 2003 to \$7.43 million in fiscal 2004. This increase was attributed principally to the following increases: \$17.09 million in total revenues, offset by increases of \$12.34 million in cost of revenues and \$1.23 million in selling expenses. As a percentage of total revenue, the operating income for fiscal 2004 accounted for 14.0% compared to 9.8% for the prior year. The increase as a percentage of total revenues was due mainly to the increase in total revenues, as well as implementation of cost control measures, which resulted in revenues growing faster than the increase in operating expenses, and an increase in government subsidies, which offset research and development expenses significantly.

*Interest expenses, net*

For the fiscal year ended June 30, 2004, net interest expense decreased slightly, by \$72,000, or 7.9%, from \$904,000 for fiscal 2003 to \$832,000. The actual interest expenses were \$894,000 and \$943,000 for fiscal years 2004 and 2003, respectively. In addition, the Company received \$62,000 of interest income in fiscal 2004 compared to \$39,000 in the prior year. As a percentage of total revenues, interest expenses accounted for 1.6% and 2.5% for fiscal 2004 and 2003, respectively. Apart from the increased total revenues, the decline was primarily attributable to enhanced management of working capital.

*Other income (expenses), net*

Net other income (expenses) amounted to \$32,000 in fiscal 2004 compared to \$21,000 in the prior year. The change in other income (expense) was immaterial to the Company's overall financial performance for fiscal 2004 and fiscal 2003.

*Subsidy income*

Net subsidy income amounted to \$3,000 in fiscal 2004 compared to \$635,000 in the prior year. Total subsidy income received from the government in fiscal 2004 amounted to \$1.57 million compared to \$1.12 million in the prior year. The Company used these subsidies to offset reported research and development expenses by approximately \$1.56 million in fiscal 2004 compared to \$481,000 in fiscal 2003. The remaining amounts of \$3,000 and \$635,000 in fiscal

2004 and 2003, respectively, were presented as a separate line item on the statement of income.

*Income tax provision*

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For the fiscal year ended June 30, 2004, the income taxes provision was \$948,000, compared to an income tax provision of \$637,000 in the prior year. This change was due to the difference in revenue recognition timing for financial reporting and income tax purposes.

The effective tax rate decreased from 18.0% in the prior year to approximately 14.0% in fiscal 2004. This was due mainly to benefits realized as a result of preferential income tax policies applied to Haotong and Hangzhou HollySys. The income tax rate reduction increased from 13.8% to 14.9% when comparing the effective tax rate of fiscal 2003 to that of fiscal 2004.

#### *Minority interest*

The minority interest amounted to \$1.04 million and \$650,000 for fiscal 2004 and 2003, respectively. The increase in minority interest was due to the increase in net income of Beijing HollySys, which resulted in an increase of \$0.3 million in minority interests.

#### *Net income*

For fiscal 2004, net income was \$4.74 million after deducting the portion attributed to minority interest, an increase by \$2.51 million compared to \$2.23 million in the prior year, a 112.6% increase. These increases were attributable primarily to the increase in revenues.

### **LIQUIDITY AND CAPITAL RESOURCES**

To date, the Company has financed its operations primarily through cash flows from operations as well as short term and long term borrowings from banks.

As of March 31, 2006, the Company had total assets of \$111.36 million, of which cash amounted to \$12.17 million, accounts receivable amounted to \$55.12 million and inventories amounted to \$8.51 million. While working capital was approximately \$25.92 million, equity amounted to \$38.16 million. The quick ratio was approximately 1.28:1.

#### **Comparison of Nine Months Ended March 31, 2006 and 2005**

Net cash provided by operating activities totaled \$8.62 million for the nine months ended March 31, 2006, an increase in positive cash flow by \$8.34 million compared to \$276,000 in the same period in the prior year, representing a 3016.8% increase. This increase resulted primarily from the following factors: 1) the increase of the changes in non-cash adjustments (\$106,000 increase in bad debt allowance, \$427,000 increase in provision for inventory obsolescence, \$359,000 increase in depreciation and amortization, \$102,000 increase in minority interest, and a decrease in investment income by \$180,000 (positive); and 2) the following changes in the cash flow from operating assets and liabilities:

\$5.27 million decrease from accounts receivable (positive);  
\$1.18 million increase from inventory;  
\$770,000 decrease from other receivable (positive);  
\$691,000 increase from deposits and other assets (negative);  
\$396,000 decrease in advance to suppliers (positive);  
\$4.44 million increase from advance from customers (positive);  
\$1.86 million increase in tax payable (positive);  
\$2.98 million decrease from accounts payable and  
\$706,000 decrease from accrued liabilities.

The decrease in cash used by accounts receivable was consistent with the increase in revenue and the Company has enhanced its collection effort to collect as much as possible of its receivables. The decrease in cash provided by other receivable also accounts for the Company's enhanced ability of receivable collections. The decreases in cash provided by accounts payable and accrued liabilities were consistent with the Company's better working capital position than the same period of the prior year, which enabled the Company to settle down these payables in a relatively short period of time although the Company has obtained very favorable payment terms with its suppliers to enhance its working capital position. The increase of \$4.44 million in cash provided by advance from customers provided the Company with a reasonable cushion for working capital purpose. The increase in provision for inventory obsolescence was due to the fact that certain previously purchased hardware products were subject to upgrade; therefore, the net realizable value of these hardware products may be reduced.

Net cash used by investing activities was \$5.87 million and \$3.76 million for the nine months ended March 31, 2006 and 2005, respectively. The cash used by investing activities consisted mainly of capital expenditures related to purchases of property, plant and equipment, construction projects and short-term and long-term investments. The increase in purchases of fixed assets was approximately \$4.36 million for the nine months ended March 31, 2006 compared to \$4.03 million for the same period of the prior year. The increases in property and equipment expenditure for both periods were incurred in Hangzhou HollySys, as this company occupied a relatively newly-constructed facility requiring machinery and equipment purchases. In the nine months ended March 31, 2006, the Company invested \$623,000 in short-term investment compared to \$284,000 in the same period of the prior year and interest income received of \$149,000 from short-term investment in the same period of the prior year. Also, it received proceeds of approximately \$403,000 from disposing some assets compared to \$404,000 in the same period of the prior year. In addition, it also had cash disbursements for long-term investments of approximately \$1.30 million for a 50% interest in Beijing Tech Energy Co., Ltd. and a 20% interest in Beijing HollySys Equipment Technology Co., Ltd. for future automation systems development.

Cash flows provided by financing activities amounted to \$1.06 million (negative) and \$2.76 million for the nine months ended March 31, 2006 and 2005, respectively. Cash flows generated by financing activities consist of proceeds of bank borrowings and disbursements for repayments to bank loans, dividend payments and amounts due to related parties. For the nine months ended March 31, 2006, the Company obtained net proceeds of \$614,000 from short-term bank loans compared to \$604,000 in the same period of the prior year. Also, it made repayments of long-term bank loans up to \$1.23 million in the nine months ended March 31, 2006 while it obtained proceeds of long-term bank loans up to \$9.67 million and made repayments of \$7.61 million in the same period of the prior year. In addition, there was a dividend payment of approximately \$334,000 by Beijing HollySys compared to \$30,000 in the same period of the prior year. Amounts due to related parties were \$112,000 (negative) and \$133,000 for the nine months ended March 31, 2006 and 2005, respectively. As a result of these changes, the financing activities for nine months ended March 31, 2006 created a decrease of \$3.82 million compared to the financing activities for the same period of the prior year.

#### **Comparison of Fiscal Years Ended June 30, 2005 and 2004**

Net cash provided by operating activities amounted to \$3.55 million, representing a decrease by \$4.65 million compared to \$8.20 million in the prior year, a 56.7% decrease. This decrease resulted primarily from the comparison of the following factors: 1) increase in net income by \$8.97 million, among the non-cash items, increase in minority interest by \$1.33 million, decrease in depreciation and amortization by \$51,000, and decrease in cash flow due to the increase in investment income by \$574,000; and 2) the following changes in cash flow from the operating assets and liabilities:

- \$11.05 million of increase in accounts receivable (negative);
- \$4.77 million of decrease in inventory;
- \$976,000 of decrease in advance to suppliers;
- \$428,000 of increase in other receivable (negative);
- \$80,000 of decrease in deposits and other assets;
- \$7.53 million of decrease in advance from customers (negative);
- \$1.22 million of increase in accounts payable;
- \$597,000 of decrease in accruals and other payable (negative); and
- \$1.67 million of decrease in income tax payable.

The increase in accounts receivable was the result from the increase in revenue, and the decrease in advance from customers was a result of timing of recognizing revenue. The inventory balance was reduced by \$1.17 million compared to the inventory balance as of June 30, 2004. All of other changes were the result of revenue recognition.

Net cash used in investing activities decreased slightly from \$4.26 million in the prior year to \$3.51 million in fiscal 2005, representing a 17.5% decrease. The major item in investing activities was \$5.63 million of cash disbursements for purchases of fixed assets compared to \$1.91 million cash disbursements for the prior year, representing a capital expenditures increase of \$3.72 million in fiscal 2005, which was for Hangzhou HollySys to acquire machinery and equipment. In order to finance capital expenditures, the Company disposed its short-term investment and received cash proceeds of approximately \$1.81 million, which mitigated the large cash disbursement for purchasing fixed assets. Also, it received proceeds of approximately \$358,000, which was mainly from disposing of its long-term investments in HollySys Communication Equipment Co., Ltd. and Dongfangjinhe Environmental Technology Co., Ltd. In the prior year, it incurred cash disbursement to purchase short-term investments for approximately \$2.29 million which established the basis for proceeds of \$1.81 million in fiscal 2005. In addition, the Company also had cash disbursement of \$225,000 for long-term investment compared to \$143,000 in the prior year. In addition, it received dividends from long-term investments amounting to \$20,000 and interest income from short-term investments of \$149,000, compared to dividends from long-term investments of \$45,000 and interest income from short-term investments of \$42,000 in the prior year.

Net cash provided by financing activities amounted to \$1.90 million, an increase by \$1.40 million compared to cash flow of \$501,000 provided by financing activities for fiscal 2004, representing a 279.3% increase. In order to finance capital expenditures and other working capital needs, the Company obtained net proceeds of \$3.2 million from short-term bank loans and \$6.65 million from long-term bank loans offsetting the repayment of \$6.4 million of long-term bank loans in fiscal 2005; whereas it obtained net proceeds of \$1.69 million from short-term bank loans and incurred repayment of \$2.05 million to long-term bank loans in fiscal 2004. In fiscal 2004, the Company received cash infusion from two owners in Hangzhou HollySys for \$600,000 while there were no similar cash flows in fiscal 2005. In addition, Beijing HollySys distributed dividends totaling \$1.51 million in fiscal 2005, while there were no such dividends paid out in fiscal 2004. The cash flow in connection with amount due to related parties decreased by \$120,000 in fiscal 2005 compared to the cash flow in connection with amount due to related parties of \$264,000 in fiscal 2004.

**Comparison of Fiscal Years Ended June 30, 2004 and 2003**

Net cash provided by operating activities amounted to \$8.20 million, representing an increase of \$7.73 million compared to the net cash of \$467,000 provided by operating activities for fiscal 2003. This increase in cash flow provided by operating activities resulted primarily from the comparison of the following factors: 1) increase in net income by \$2.51 million and the changes in non-cash adjusting items including increase in minority interest by \$391,000 (positive), increase in depreciation and amortization by \$233,000 (positive), decrease in investment income by \$156,000 (positive); and 2) the changes in cash flow from the operating assets and liabilities, principally from the following:

- \$3.29 million of increase in accounts receivable (negative);
  - \$2.91 million of increase in inventory (negative);
- \$1.80 million of increase in advances to suppliers (negative);
  - \$412,000 increase in other receivable (negative);
- \$318,000 of decrease in deposits and other assets (positive);
- \$5.16 million of increase in advance from customers (positive);
  - \$3.91 million of increase in accounts payable (positive);
- \$3.15 million of increase in accrued liabilities (positive); and
  - \$134,000 of increase in tax payable.

The increase in accounts receivable was the result from the increase in revenue. The increases in advance to suppliers and in inventory for fiscal 2004 were the basis for the increase of revenue in fiscal 2005 compared to the increases in advance to suppliers and inventory for fiscal 2003. Along with the increase in revenue, the balance in other receivable also increased resulting in a negative cash flow of \$412,000 compared to the balance of other receivable for fiscal 2003. The increase in advance from customers, in accounts payables, and accrued liabilities provided the Company with a reasonable cushion for working capital purpose. All of those changes were the result of revenue recognition.

Net cash used in investing activities increased from \$2.51 million in fiscal 2003 to \$4.26 million in fiscal 2004, representing a 69.8% increase in fiscal 2004. The increase in cash flow used in investing activities was due mainly to purchase of short-term investments by \$2.29 million, an increase by \$2.02 million compared to only \$269,000 in fiscal 2003, representing a 749.6% increase, which provided a cash surplus available for future investment. Capital expenditures in fiscal 2004 were approximately \$1.91 million, an increase by \$281,000 compared to \$1.63 million for fiscal 2003, representing a 17.2% increase. In fiscal 2003, the Company spent approximately \$687,000 to acquire 70% equity interest in Haotong while there was no such cash disbursement in fiscal 2004.

Net cash flow provided by financing activities totaled \$501,000 in fiscal 2004, a decrease by \$308,000 compared to \$809,000 for fiscal 2003, representing a 38.1% decrease. In fiscal 2004, the Company obtained net borrowing from short-term bank loans by \$1.69 million whereas there was a net repayment of \$2.05 million in fiscal 2003, a net

change of \$3.75 million. It made a repayment of long-term bank loans of \$2.05 million in fiscal 2004 compared to \$2.00 million in fiscal 2003. Also, it obtained proceeds of \$4.83 million from long-term bank loans in fiscal 2003 compared to the zero proceeds in fiscal 2004. In fiscal 2004, it increased the amount due to related parties by approximately \$263,000 whereas it increased the amount due to related parties by only \$24,000 in fiscal 2003. As a result of these changes, the financing activities for fiscal 2004 created a decrease of \$308,000 compared to the financing activities for fiscal 2003.

**Working Capital**

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The Company's working capital has been increasing over the reporting periods with growth rates of 90.1% between fiscal 2005 and 2004 and 15.7% between the nine-month periods ended March 31, 2006 and fiscal 2005, respectively.

Total current assets at June 30, 2005 amounted to \$78.48 million, an increase by approximately \$21.97 million compared to \$57.51 million at June 30, 2004. Total current assets increased up to approximately \$88.60 million at March 31, 2006. The increases was attributable mainly to larger amounts of cash and cash equivalents, contract performance deposits in banks, accounts receivable, and advances to suppliers, all of which resulted from increasing operating results. Contract performance deposits were in connection with the Company's bidding processes. Normally, the customer required the Company to set aside some money in banks as a guarantee for the bids. The increase in Contract performance deposits in banks was a result of the Company's revenue growth. The accounts receivable were classified into billed and unbilled accounts receivables based on the percentage of completion method for revenue recognition. Normally, the Company makes a down payment to its suppliers mainly for the purchases of equipment and materials to fulfill its commitments to its customers. Therefore, the growing balances of cash and cash equivalents, contract performance deposits in banks, accounts receivable, and advances to suppliers reflect the increased operating revenues.

Current liabilities amounted to \$62.68 million at March 31, 2006, in comparison to \$56.08 million at June 30, 2005 and \$45.72 million at June 30, 2004, respectively. The increases have been attributable mainly to the increases in short-term loans, current portion of long-term loans, deferred revenue, accrued payrolls, warranty liabilities, accrued liabilities and a decrease in other tax payables. In order to optimize its debt structure, the Company has increased its short-term borrowings while decreasing the proportion of long-term borrowings for obtaining benefit from the relatively lower interest rates. Deferred revenue resulted from the excess of the billed amounts over revenues recognized on the contracts and the billings were rendered based on agreed milestones included in the contracts with customers. Therefore, deferred revenue was in the nature of advances from customers. The increase in deferred revenue was an important component of working capital and related closely to the Company's revenue growth. Accrued payrolls mainly consisted of employee welfare provision of Beijing HollySys, Haotong and Hangzhou HollySys according to various Chinese laws, and one-month accrued salary expenses and year-end bonuses. The Company provided warranty expenses to its customers for after-sales services. Warranty liabilities were provided based on 1.5% of the integrated contract revenue during the period and the difference from the former period, and were charged into cost of integrated contracts. Accrued liabilities mainly consisted of payables for some daily operations, such as housing funds, labor union fees and other current liabilities. The increase in accrued liabilities was a result of revenue growth. Other tax payables mainly consisted of value added tax ("VAT") payable and were resulted from the revenue growth over these periods. The Company paid out more VAT payable amount during the nine months ended March 31, 2006.

The current ratio increased from 1.26 at June 30, 2004 to 1.40 at June 30, 2005, and increased to 1.41 at March 31, 2006. The changes in current ratio were due mainly to the growth of operating activities. In order to finance operating activities, the Company had maintained a good standing of current ratio due primarily to the following two factors: first, enhance accounts receivable collection; and second, increase short-term debts in order to facilitate flexibility of borrowing.

### **Capital Resources**

The Company has obtained working capital through several ways. First, it obtained short-term and long-term bank loans. Second, its suppliers were willing to provide it with extended payment terms which would not force it to increase bank borrowings unless it planned to increase its operating scale significantly. Third, through the improved bidding mechanism, it asked its customers to increase their payments in the early stage of contract performance process to diminish its working capital demands for daily operations. Fourth, it has maintained good relationships with commercial banks which provided it with the necessary bank financing. At March 31, 2006, the Company had established standby credit facilities with domestic commercial banks for aggregate approximately \$33.36 million to

finance any funding needs related to its projects and relevant working capital requirements. Finally, it may issue corporate bonds to the public in the future. The Company believes that it will be able to obtain adequate cash flow for its operating activities and will continue to improve its cash collection to satisfy the cash demands from its daily operations.

### **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

The following table sets forth the Company's contractual obligations, including long-term and short-term loans and operating leases, and capital and operational commitments at of June 30, 2005.

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Item	Less than 1	1-2 years	2-3 years	3-5 years	More than	Total
	year				5 years	
	\$	\$	\$	\$	\$	\$
Long-term Bank Loans	1,208,240	6,645,321	-	-	-	7,853,561
Interest payable	34,646	741,437	-	-	-	776,083
Short-term Bank Loans	8,699,329	-	-	-	-	8,699,329
Interest payable	281,354					281,354
Short-term loan from a related party	2,416,480	-	-	-	-	2,416,480
Interest payable	51,809					51,809
Operating Lease Commitment (1)	50,000	-	-	-	-	50,000
Purchase Commitment (2)	1,614,946	-	-	-	-	1,614,946
Total	14,356,804	7,386,758				21,743,562

### (1) Operating Lease Commitment

Beijing HollySys entered into a lease agreement with HollySys Information Technology Co., Ltd., in which HollySys holds 40% interest, to lease office space. The lease agreement is renewable on an annual basis. The basic rental price has ranged from RMB1.4 or RMB1.5 per square meter per day during the past five years. The total rental per year depends on the actually total square meters leased each year. The total rental expense for the years ended June 30, 2003, 2004 and 2005 was \$107,000, \$116,000, and \$57,000, respectively. The rental expense for the nine months ended March 31, 2005 and 2006 was \$51,000 and \$57,000, respectively.

### (2) Purchase Commitment

As of June 30, 2005, the Company had approximately \$1.61 million in purchase obligations including \$1,493,533 for construction of factory premises and \$121,414 for purchases of equipment, mainly for Hangzhou HollySys.

	RMB	US Dollars
Plant and building construction	12,361,225	1,493,533
Equipment	1,004,880	121,414
Total	13,366,105	1,614,946

Other than the contractual obligation and commercial commitments set forth above, the company does not have any other long-term debt obligations, operating lease obligations, purchase obligations or other long-term liabilities.

### OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties as of March 31, 2006. It has have not entered into any foreign currency forward contract. It does not have any other off-balance sheet arrangements except for the contractual obligations and commitments mentioned above as of March 31, 2006. The Company believes that there are no off-balance sheet arrangements that have or are reasonably likely to have a material effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### EMPLOYEES AND THEIR BENEFITS

At March 31, 2006, Beijing HollySys and Hangzhou HollySys had a total of 1,204 employees. The remuneration package of the employees includes salary, bonuses and allowances. Employees also receive welfare benefits including

workers' insurance, medical care, housing subsidies, child care and education, and other miscellaneous items.

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The Company believes that its success in attracting and retaining highly skilled technical employees and sales and marketing personnel is largely a product of its commitment to providing a motivating and interactive work environment that features continuous and extensive professional development opportunities, as well as frequent and open communications at all levels of the organization.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

In November 2004, the FASB issued Statement of Accounting Standards No. 151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4" (SFAS No. 151). SFAS No. 151 eliminates the "so abnormal" criterion in ARB No. 43 "Inventory Pricing." SFAS No. 151 no longer permits a company to capitalize inventory costs on its balance sheets when the production defect rate varies significantly from the expected rate. SFAS No. 151 reduces the differences between U.S. and international accounting standards. SFAS No. 151 is effective for inventory costs incurred during annual periods beginning after June 15, 2005. The Company does not believe that this pronouncement will have a material effect on its financial position and net income.

In December 2004, the FASB issued the Statement of Financial Account Standards No. 153, "Exchange of Nonmonetary Assets, An Amendment of APB Opinion No. 29" (SFAS No. 153). SFAS No 153 addresses the measurement of exchanges of nonmonetary assets. SFAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, Accounting for Nonmonetary Transactions, and replaces it with an exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of SFAS No. 153 shall be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date this Statement is issued. The provisions of this Statement shall be applied prospectively. The Company does not believe that this pronouncement will have a material effect on its financial position and net income.

In May 2005, the FASB issued Statement No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements." (SFAS No. 154). SFAS No. 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS No. 154 generally requires retrospective application to the prior period financial statements of voluntary changes in accounting principles. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. However, SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements. The Company does not believe that the adoption of SFAS No. 154 will have a material effect on its results of operations or financial condition.

## **QUANTITATIVE AND QUALITATIVE MARKET RISKS**

### **Industrial environment and national industrial development policies**

The Company is highly sensitive to industry environment changes and state industrial development policies. State industrial development policies have established clear targets for market capacities of automation systems in the short and long run. These are crucial to the development of the Company, especially for rail transport and nuclear power plant automation systems. At present, state policies are favorable to the Company's development. If the government ceases supporting the rail transportation and nuclear industries, however, it would bring about a negative impact on operating results in the next a few years.

The Company relies on market research and technology development to ensure that it delivers attractive, high-quality products and services to its customers as a way to protect against risks connected with a change in the competitive environment.

**Taxation risk**

As a result of various tax regulations, Beijing HollySys, Hangzhou HollySys and Haotong HollySys are entitled to the benefits afforded by certain preferential income tax policies. These preferential tax policies will terminate in one to three years.

With the aim of attracting foreign investment, the Chinese government provides favorable income tax rates to foreign-invested enterprises in China at the levels of 15%, 24% and 30%. Domestic-invested enterprises, on the other hand, normally are subject to a 33% income tax rate. The Chinese government has indicated that it intends to eliminate differences between the applicable tax rates of domestic and foreign-invested enterprises, but the schedule for the unification of tax rates has not yet been established. When the preferential tax treatment is ended, it will increase taxes and reduce the Company's after tax profits.

Additionally, the China government provides subsidies (sourcing from the proceeds of VAT collected) to all domestic enterprises which are involved in software development. Since this subsidy policy became effective, the Company has enjoyed subsidies for software development, which has been an integral part of the Company's integrated contracts. The subsidy policy will cease at the end of 2010. When the termination of the subsidy policy occurs, it will cause after-tax income to decline by approximately 3%.

The Company is confident that its continuing business development coupled with effective cost-control methods, will contribute to achieving positive financial results that will offset the adverse impacts that will result from the elimination of these tax preferences.

### Foreign exchange risk

The Company conducts its business primarily in Chinese RMB currency, although it does have plans to expand its business internationally.

RMB is not a freely convertible currency. The restrictions on foreign exchange imposed by the Chinese government may result in the material differences between the future exchange rate and the current exchange rate or historical exchange rate. The changes in the exchange rate of RMB currency will impose foreign exchange translation risk on the Company's financial statements and impact the Company's ability to carry out operations related to foreign exchange. Those changes also will impact its ability to pay dividends in US dollars. The Company believes that, however, it is, and will be, able to obtain sufficient foreign exchange to implement the above-mentioned operations and hedge against foreign exchange risk.

### Interest rate risk

Over the years, the Company has tended to obtain proceeds from short-term bank loans for working capital financing purpose. Therefore, it is subject to market rate risks due to fluctuations in interest rates charged on these loans. At March 31, 2006, the Company's short-term bank loan borrowing was \$12,099,742, of which \$4,989,584 located in HollySys, \$ 7,110,158 located in Hangzhou HollySys. All the short-term bank loans (maturing from six months to one year) had fixed interest rates ranging from 5.22% to 5.76% per annum. However, when these short-term bank loans are renewed, the interest rates are subject to change based on the notice from the People's Bank of China, the central bank of China. It is not possible to know if those interest will increase, or by how much.

Most of the short-term bank loans were guaranteed by the Company related parties and third parties and one bank loan of \$2,416,480 at June 30, 2005 and \$3,472,188 at March 31, 2006 in Hangzhou HollySys was collateralized by its plant and property. At March 31, 2006, there was a bank loan of \$2,494,792 payable to a commercial bank which served as a trustee appointed by HollySys Information Technology Co., Ltd. in which HollySys holds 40% interest. This loan had interest rate of 5.31%, 5.76% and 5.76% at June 30, 2004 and 2005 and at March 31, 2006, which is the same market rate charged by that commercial bank for the loans lent with similar terms to the similarly situated borrowers.

The following table provides information, by maturity dates, regarding the Company's interest rate sensitive financial instruments, which consist of fixed rate short-term and long-term debt obligations as of March 31, 2006.

Lender	Balance at March 31, 2006	Maturity Date	Interest Rate	Floating or Fixed Interest Rate	Current portion
Long-term loans					
Bank of Beijing	1,871,094		5.49%		

		July 15, 2007		Fixed rate	
CITIC Trust & Investment Co., Ltd.,	4,989,584	January 21, 2007	7.002%	Fixed rate	4,989,584
<b>Total</b>	<b>6,860,678</b>				<b>4,989,584</b>

**Short-term loans**

CITIC Industrial Bank	1,247,396	April 19, 2006	5.22%	Fixed rate	
China Merchants Bank	1,247,396	August 22, 2006	5.58%	Fixed rate	
Industrial and Commercial Bank of China (HangZhou)	2,494,792	May 31, 2006	5.58%	Fixed rate	
Industrial and Commercial Bank of China (HangZhou)	1,247,396	August 16, 2006	5.58%	Fixed rate	
Industrial and Commercial Bank of China (HangZhou)	1,871,094	November 9, 2006	5.58%	Fixed rate	
Industrial and Commercial Bank of China (HangZhou)	623,698	May 10, 2006	5.22%	Fixed rate	
Industrial and Commercial Bank of China (HangZhou)	873,117	December 20, 2006	5.58%	Fixed rate	
<b>Total</b>	<b>9,604,950</b>				

Short-term bank loan from  
related parties

HollySys Information Technology	2,494,792	November 5, 2006	5.76%	Fixed rate	
<b>Total</b>	<b>2,494,792</b>				

## **FUTURE DEVELOPMENT AND BUSINESS STRATEGIES**

The Company's goal is to become one of the leading automation and process control system companies over the world. It plans to concentrate its research and development resources on core technologies such as I/O signal processing technology, network protocol interface, HOLLiAS DCS platform, software development and application system design to maintain technological advantages over the Company's competitors. The Company's principal elements of business strategies are:

- To maintain leadership in China's DCS market;
- To enhance the Company's leading position in technology;
- To leverage the Company's large customer base to offer total solutions; and
- To focus on high-value tailored technology services.

## INFORMATION ABOUT CHARDAN

### **Business of Chardan**

#### *General*

Chardan was formed on March 10, 2005, to serve as a vehicle to effect a stock purchase, capital stock exchange, asset acquisition or other similar business combination with an unidentified operating business that has its primary operating facilities located in the PRC in any city or province north of the Yangtze River. Prior to executing the Stock Purchase Agreement with the HollySys Stockholders, Chardan's efforts were limited to organizational activities, completion of its initial public offering and the evaluation of possible business combinations.

#### *Offering Proceeds Held in Trust*

Chardan consummated its initial public offering in August 2005. The net proceeds of the offering, after payment of underwriting discounts and expenses, were approximately \$30.9 million. Of that amount, approximately \$29.8 million was placed in the trust account and invested in government securities. The remaining proceeds have been or are being used by Chardan in its pursuit of a business combination. The trust account will not be released until the earlier of the consummation of a business combination or the liquidation of Chardan. The trust account contained approximately \$30,260,861 as of December 31, 2005. If the stock purchase with the HollySys Stockholders is consummated, the trust account will be released to Chardan, less:

- amounts paid to stockholders of Chardan who do not approve the stock purchase and elect to convert their shares of common stock into their pro-rata share of the trust account; and
- the cash payment being paid to the HollySys Stockholders in the stock purchase.

#### *Fair Market Value of Target Business*

Pursuant to Chardan's Certificate of Incorporation, the initial target business that Chardan acquires must have a fair market value equal to at least 80% of Chardan's net assets at the time of such acquisition. Chardan's board of directors determined that this test was clearly met in connection with its acquisition of HollySys.

#### *Stockholder Approval of Business Combination*

Chardan will proceed with the acquisition of HollySys only if a majority of all of the outstanding shares of Chardan is voted in favor of the stock purchase and Redomestication Merger proposals. The stockholders existing prior to the initial public offering have agreed to vote their common stock on these proposals in accordance with the vote of the majority of shares issued in the initial public offering. If the holders of 20% or more of Chardan's common stock vote against the stock purchase proposal and demand that Chardan convert their shares into their pro rata share of the trust account, then Chardan will not consummate the stock purchase. In this case, Chardan would be able to present another potential business combination to its stockholders, subject to the time limitations set forth below.

#### *Liquidation if no business combination*

If Chardan does not complete a business combination by February 10, 2007, or by August 10, 2007 if the extension criteria described below have been satisfied, Chardan will be dissolved and will distribute to all of its public stockholders, in proportion to their respective equity interests, an aggregate sum equal to the amount in the trust account, inclusive of any interest, plus any remaining net assets. Chardan's existing stockholders have waived their rights to participate in any liquidation distribution with respect to shares of common stock owned by them

immediately prior to the initial public offering. There will be no distribution from the trust account with respect to Chardan's warrants.

If Chardan were to expend all of the net proceeds of the initial public offering, other than the proceeds deposited in the trust account, the per-share liquidation price as of December 31, 2005 would be \$5.26, or \$0.74 less than the per-unit offering price of \$6.00 in Chardan's initial public offering. The proceeds deposited in the trust account could, however, become subject to the claims of Chardan's creditors and there is no assurance that the actual per-share liquidation price will not be less than \$5.26, due to those claims.

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If Chardan enters into either a letter of intent, an agreement in principle or a definitive agreement to complete a business combination prior to February 10, 2007, but is unable to complete the business combination by February 10, 2007, then Chardan will have an additional six months in which to complete the business combination contemplated by the letter of intent, agreement in principle or definitive agreement. If Chardan is unable to do so by August 10, 2007, upon notice from Chardan, the trustee of the trust account will commence liquidating the investments constituting the trust account and will turn over the proceeds to the transfer agent for distribution to the stockholders holding shares acquired through the initial public offering.

The stockholders holding shares of Chardan common stock issued in the initial public offering will be entitled to receive funds from the trust account only in the event of Chardan's liquidation or if the stockholders seek to convert their respective shares into cash and the stock purchase is actually completed. In no other circumstances shall a stockholder have any right or interest of any kind to or in the trust account.

### ***Facilities***

Chardan maintains executive offices at 625 Broadway, Suite 1111, San Diego, California 92101. The cost for this space is included in a \$7,500 per-month fee that Chardan Capital, LLC, the lessee of that space and an affiliate of Dr. Richard D. Propper, Jiangnan Huang and Zhang Li, charges Chardan for general and administrative services. Chardan believes, based on rents and fees for similar services in the San Diego area, that the fees charged by Chardan Capital, LLC are at least as favorable as Chardan could have obtained from an unaffiliated person. Chardan considers its current office space adequate for current operations.

### ***Employees***

Chardan has four directors, three of whom also serve as officers. These individuals are not obligated to contribute any specific number of hours to Chardan's business per week, and they intend to devote only as much time as they deem necessary to Chardan's affairs. Chardan has no paid employees.

### ***Periodic Reporting and Audited Financial Statements***

Chardan has registered its securities under the Securities Exchange Act of 1934 and has reporting obligations, including the requirement to file annual and quarterly reports with the SEC. In accordance with the requirements of the Securities Exchange Act of 1934, Chardan's annual reports will contain financial statements audited and reported on by Chardan's independent accountants. Chardan has filed with the Securities and Exchange Commission a Form 10-QSB covering the fiscal quarter ended September 30, 2005.

### **Legal Proceedings**

There are no legal proceedings pending against Chardan.

### **Plan of Operations**

The following discussion should be read in conjunction with Chardan's Financial Statements and related notes thereto included elsewhere in this proxy statement/prospectus.

Chardan was formed on March 10, 2005 to serve as a vehicle to effect a stock purchase, capital stock exchange, asset acquisition or other similar business combination with an unidentified business that has its primary operating facilities located in the PRC in any city or province north of the Yangtze River. Chardan closed its initial public offering on August 10, 2005. All activity from March 10, 2005 through August 10, 2005 related to its formation and initial public offering.

Chardan incurred a net loss of \$101,742 for the year ended December 31, 2005. Chardan's total costs and expenses, all of which were related to our formation, maintenance of our corporate status and efforts to find and evaluate target businesses, were approximately \$454,000, consisting principally of the following: travel and entertainment expenses, consulting fees, directors and officers liability insurance, amounts paid to a related party under a monthly administrative services agreement, professional fees, state franchise taxes and miscellaneous expenses. Those expenses were offset by interest income of approximately \$348,000 on the trust fund investments and funds outside the trust fund, excluding deferred interest.

Consulting expenses of \$66,700 were paid pursuant to an agreement Chardan entered into with Greatace, Ltd., a China-based consulting firm, during the quarter ended September 30, 2005, to assist in Chardan's search for prospective target companies in the northern portion of China. Greatace has also performed due diligence on prospective target businesses and assisted Chardan in structuring the business combination with Gifted Time Holdings. In the event that Chardan consummates the transaction with Gifted Time Holdings, Chardan is obligated to pay Greatace an additional \$133,300.

Approximately \$29.8 million of the net proceeds of the initial public offering are in trust, with the remaining net proceeds of approximately \$1.1 million available to pay for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses. Chardan will use substantially all of the net proceeds of its initial public offering not held in trust to identify and evaluate prospective acquisition candidates, select the target business, and structure, negotiate and consummate the business combination. Chardan intends to utilize its cash, including the funds held in the trust fund, capital stock, debt or a combination of the foregoing to effect a business combination. To the extent that its capital stock or debt securities are used in whole or in part as consideration to effect a business combination, the proceeds held in the trust fund as well as any other available cash to finance the operations of the target business

Chardan intends to utilize its cash, including the funds held in the trust account, capital stock, debt or a combination of the foregoing to effect a business combination. Under the agreement governing the proposed transaction, up to \$27,000,000 will be paid at the closing to the HollySys Stockholders to acquire their shares. The remaining funds in the trust account will be used to finance the operations of HLS and, if needed, to pay a portion of the deferred purchase price. Uses of those proceeds will include, among other things, the following:

- Payment of the accrued expenses of Chardan as of the date of the closing of the transaction;
- To support internal expansion of HLS's operations, including increased hiring expansion of existing facilities or the acquisition or construction of new facilities, expenditures to increase the geographic markets within China in which HLS operates and expansion of the production and distribution networks needed to accomplish that geographic market extension; and
- To increase research and development to enable HLS to expand its product offering, including the development of nuclear power plant automation and transportation automation.

Chardan is obligated, commencing August 2, 2005 to pay to Chardan Capital, LLC, an affiliate of Dr. Richard D. Propper, its chairman of the board, Jiangnan Huang, a director and chief executive officer and Zhang Li, a director and chief financial officer, a monthly fee of \$7,500 for general and administrative services.

In connection with its initial public offering, Chardan issued an option for \$100 to the representative of the underwriters to purchase 250,000 units at an exercise price of \$7.50 per unit. Chardan has accounted for the fair value of the option, inclusive of the receipt of the \$100 cash payment, as an expense of the public offering resulting in a charge directly to stockholders' equity. Chardan estimates that the fair value of this option is approximately \$550,000 (\$2.20 per unit) using a Black-Scholes option-pricing model. The fair value of the option granted to the representative is estimated as of the date of grant using the following assumptions: (1) expected volatility of 44.5%, (2) risk-free interest rate of 3.8% and (3) expected life of five years. The option may be exercised for cash or on a "cashless" basis at the holder's option such that the holder may use the appreciated value of the option (the difference between the exercise prices of the option and the underlying warrants and the market price of the units and underlying securities) to exercise the option without the payment of any cash. In addition, the warrants underlying such Units are exercisable at \$6.65 per share.

#### **Off-Balance Sheet Arrangements**

Warrants and representative's unit purchase option issued in conjunction with our initial public offering are equity linked derivatives and accordingly represent off balance sheet arrangements. In addition, the conversion feature of the representative's unit purchase option constitutes an embedded derivative. The warrants, unit purchase option and conversion feature meet the scope exception in paragraph 11(a) of FAS 133 and are accordingly not accounted for as derivatives for purposes of FAS 133, but instead are accounted for as equity. See Footnote 5 to the financial statements for more information.

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**PRO FORMA**

**UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS**

Pursuant to a Stock Purchase Agreement dated February 2, 2006 (the “Stock Purchase Transaction”), Chardan North China Acquisition Corporation (“Chardan”) agreed to purchase 100% of the interest of Gifted Time Holdings Limited (“Gifted Time Holdings”) in exchange for consideration including cash of \$30 million and 23.5 million shares of HLS Systems International Limited (“HLS”), a subsidiary of Chardan that will merge with Chardan with HLS as the surviving entity (the “Chardan Merger”). Each share of common stock of Chardan will automatically convert into one share of common stock of HLS. The 23.5 million shares of HLS will represent not less than 77% of total outstanding shares following the Chardan Merger if all of the existing shareholders of Chardan approve the stock purchase transaction and no warrants are exercised. If all of the existing shareholders of Chardan exercise their warrants and no shareholder redeems his or her shares into cash, then the 23.5 million shares to be issued to the shareholders of Gifted Time Holdings will represent no less than 54.9% of the outstanding shares of HLS following the Chardan Merger.

The Stock Purchase Transaction will result in the shareholders of Gifted Time Holdings obtaining a majority of the voting interest in HLS. Generally accepted accounting principles require that the company whose shareholders retain the majority voting interest in a combined business be treated as the acquirer for accounting purposes. Because Chardan does not have any assets with operating substance except cash, the Stock Purchase Transaction has been accounted for as a reorganization and recapitalization of Gifted Time Holdings with a carry-over basis. The cash payment of \$30 million to the shareholders of Gifted Time Holdings has been accounted for as a capital distribution.

The following unaudited pro forma combined financial statements give effect to the Stock Purchase Transaction based on the assumptions and adjustments set forth in the accompanying notes, which management believes is reasonable. The following unaudited pro forma financial statements and accompanying notes should be read in conjunction with the audited historical financial statements and related notes of Chardan from Chardan’s inception (March 5, 2005) to December 31, 2005 and Gifted Time Holdings, which are included in this document.

The following unaudited pro forma balance sheet combines the financial position of Gifted Time Holdings and Chardan as of March 31, 2006 as if the Stock Purchase Transaction occurred on March 31, 2006. The following unaudited pro forma combined income statements give effect to the reorganization and recapitalization transaction of Gifted Time Holdings assuming that the reorganization and recapitalization transaction took place on January 1, 2005.

The following unaudited pro forma combined financial statements have been prepared using two different levels of approval of the Stock Purchase Transaction by the Chardan stockholders, as follows:

- Maximum Approval: This presentation assumes that 100% of Chardan stockholders approve the Stock Purchase Transaction; and
- Minimal Approval: This presentation assumes that only 80.01% of Chardan stockholders approve the Stock Purchase Transaction. (Accordingly, 1,149,425 shares were assumed to be redeemable upon voting against approving the contemplated Stock Purchase Transaction, and the amount of \$5,964,017 was set aside for possible redemption).

The unaudited pro forma combined financial information is presented for illustrative purposes only and is not necessarily indicative of the operation results that would have actually achieved if the Stock Purchase Transaction had consummated as of the beginning of the period indicated, nor is it necessarily indicative of the future operating results of the combined business.

**Pro Forma Assumption and Adjustments:**

- (a) to record the release of funds held in trust by Chardan.
- (b) to record the cash portion of the purchase price, including the initial cash payment, and the accrual of the remaining payment for an aggregate of \$30,000,000.
- (c) to record an estimated reduction in interest income due to payment of the cash portion of the purchase price.
- (d) assuming maximum approval, to reclassify common stock held in trust to permanent equity and to record related deferred interest as income.
- (e) assuming minimum approval, to record the refund of funds to dissenting shareholders.
- (f) to record the stock portion of the purchase price, the issuance of 23,500,000 shares of Chardan common stock for all the shares of Gifted Time Holdings Limited.
- (g) to eliminate the accumulated deficit (as adjusted when assuming maximum approval) of Chardan, as Gifted Time Holdings Limited will be the continuing entity for accounting purposes.

(h) Pro forma net income per share was calculated by dividing pro forma net income by the weighted average number of shares outstanding as follows:

	<b>Three Months Ended March 31, 2006</b>	
	<b>Maximum Approval (100%)</b>	<b>Minimum Approval (80.01%)</b>
Shares issued in the Transaction	23,500,000	23,500,000
Weighted average shares outstanding in Chardan	7,000,000	5,850,575
Incremental shares relating to warrants exercised	5,992,337	5,992,337
Incremental shares relating to Underwriter's purchase option	255,679	255,679
Weighted average common shares - diluted	36,748,016	35,598,591

	<b>Year Ended December 31, 2005</b>	
	<b>Maximum Approval (100%)</b>	<b>Minimum Approval (80.01%)</b>
Shares issued in the Transaction	23,500,000	23,500,000
Weighted average shares outstanding in Chardan	4,020,202	3,466,438
Incremental shares relating to warrants exercised	630,435	630,435
Incremental shares relating to Underwriter's purchase option	-	-
Weighted average common shares - diluted	28,150,637	27,596,873

The shares underlying the underwriter's purchase option have not been considered for the year ended December 31, 2005 since the related exercise price is in excess of the average market price during the period. There are no other diluted instruments in Chardan.

**HLS SYSTEMS INTERNATIONAL LIMITED**  
**(Formerly Chardan North China Acquisition Corporation and Successor of Gifted Time Holdings Limited)**  
**Pro Forma Combined Balance Sheet (Maximum Assumption)**  
**March 31, 2006 (Unaudited)**

	<b>Gifted Time Holdings Limited</b>	<b>Chardan North China Acquisition Corporation</b>	<b>Pro Forma Adjustments</b>	<b>Pro forma Combined</b>
<b>ASSETS</b>				
Current Assets:				
Cash and cash equivalents	\$ 12,169,617	\$ 388,299	30,563,675 (a) (27,375,783) (b)	15,745,808
Investments held in trust	-	30,563,675	(30,563,675) (a)	-
Contract performance deposit in banks	2,104,359	-		2,104,359
Short-term deposit	187,109	-		187,109
Notes receivable	1,122,656			1,122,656
Accounts receivable	55,118,098	-		55,118,098
Other receivables	1,847,788	-		1,847,788
Advances to suppliers	7,522,430	-		7,522,430
Inventories	8,511,223	-		8,511,223
Deferred tax assets	-	332,345		332,345
Prepaid expenses and other current assets	18,711	33,503		52,214
<b>Total current assets</b>	<b>88,601,991</b>	<b>31,317,822</b>	<b>(27,375,783)</b>	<b>92,544,030</b>
Property, plant and equipment, net	17,459,698	-		17,459,698
Long term investments	5,296,302	-		5,296,302
<b>Total assets</b>	<b>\$ 111,357,991</b>	<b>\$ 31,317,822</b>	<b>\$ (27,375,783)</b>	<b>\$ 115,300,030</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Current Liabilities:				
Short-term bank loans	9,604,950	-		9,604,950
Short-term bank loan from related parties	2,494,792	-		2,494,792
Current portion of long-term loans	4,989,584			4,989,584
Accounts payable	17,438,677	-		17,438,677
Deferred revenue	12,050,403	-		12,050,403
Accrued payroll and related expense	4,567,000	-		4,567,000
Income tax payable	1,194,248	129,882		1,324,130
Warranty liabilities	1,735,679	-		