

Hollysys Automation Technologies, Ltd.  
Form 20-F/A  
March 08, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 20-F/A**

**(Amendment No. 1)**

**(Mark One)**

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

**OR**

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

For the fiscal year ended June 30, 2015

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

**OR**

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

Date of event requiring this shell company report \_\_\_\_\_

Commission file number: **001-33602**

**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.**

(Exact name of Registrant as specified in its charter)

**Not Applicable**

(Translation of Registrant's name into English)

**British Virgin Islands**

(Jurisdiction of incorporation or organization)

**No. 2 Disheng Middle Road,**

**Beijing Economic-Technological Development Area,**

**Beijing, P. R. China 100176**

(Address of principal executive offices)

**Arden Xia, Tel: (86 10) 5898 1386, Email: xiachuan@hollysys.com**

**Address: No. 2 Disheng Middle Road, Beijing Economic-Technological Development Area, Beijing, P.R. China 100176**

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
<b>Ordinary Shares, \$0.001 par value per share</b>	<b>The NASDAQ Global Select Market</b>

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

**None**

(Title of Class)

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

**None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or ordinary shares as of the close of the period covered by the annual report (June 30, 2015): 58,358,521 ordinary shares.

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large accelerated filer       Accelerated filer       Non-accelerated filer

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

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

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

Item 17       Item 18

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

## EXPLANATORY NOTE

This Amendment No. 1 to annual report on Form 20-F (this “Amendment No.1”) amends our annual report on Form 20-F for the year ended June 30, 2015 that was filed with the Securities and Exchange Commission (the “Commission”) on September 25, 2015 (the “Form 20-F”). This Amendment No.1 is being filed in response to comments received from the staff of the Commission in order to amend the following sections of the Form 20-F:

the auditor’s opinion. Due solely to a clerical error, we inadvertently included a wrong version of the opinion of our independent registered public accounting firm, Ernst & Young Hua Ming LLP in the Form 20-F. We are filing this Amendment No.1 to submit the actual and correct version of the opinion of Ernst & Young Hua Ming LLP.

Note 6 to the consolidated financial statements for the years ended June 30, 2013, 2014 and 2015 with respect to a typographical error.

As required by Rule 12b-15 under the Exchange Act of 1934, as amended, updated certifications of our principal executive officer and our principal financial officer are being filed as exhibits to this Amendment No. 1. This Amendment No. 1 also includes a new Exhibit 15.1, which contains the consent of our independent registered public accounting firm with respect to this Amendment No. 1. Other than as described above, this Amendment No. 1 speaks as of the date of the initial filing of the Form 20-F and does not, and does not purport to, amend, update or restate the information in the Form 20-F or reflect any events that have occurred after the Form 20-F was filed.

## **ITEM 8. FINANCIAL INFORMATION**

### **A. Consolidated Statements and Other Financial Information**

We have appended consolidated financial statements filed as part of this Annual Report. See Item 18 “Financial Statements.”

#### Legal Proceedings

We are currently not a party to any material legal or administrative proceedings, and we are not aware of threatened material legal or administrative proceedings against us. We may from time to time become a party to various legal or administrative proceedings arising in the ordinary course of our business.

#### Dividend Policy

Historically we have retained our earnings for use in the expansion and operation of our business. On February 9, 2015, we declared a special cash dividend of US\$0.40 per share to the holders of the Company’s ordinary shares. The record day was February 23, 2015, and payment day was March 16, 2015. Continental Stock Transfer & Trust acted as the paying agent. Any future determination relating to our dividend policy will be made at the discretion of our board of directors, based on our financial condition, results of operations, earnings, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant.

Notwithstanding the understanding that earnings will be accumulated, our ability to pay dividends depends substantially on the receipt of dividends to us by our subsidiaries.

For the PRC subsidiaries, each of them may pay dividends only out of its accumulated distributable profits, if any, determined in accordance with its articles of association and the accounting standards and regulations in China. Pursuant to applicable PRC laws and regulations, 10% of after-tax profits of each of our consolidated PRC entities are required to be set aside in a statutory surplus reserve fund annually until the reserve balance reaches 50% of such PRC entity’s registered capital. Allocations from these statutory surplus reserves may only be used for specific purposes and are not distributable to us in the form of loans, advances, or cash dividends.

Under the New EIT Law and its implementation rules issued by the PRC State Council, both of which became effective on January 1, 2008, dividends from our PRC subsidiaries to us may be subject to a withholding tax at the rate of 10% if the dividend is derived from profits generated after January 1, 2008. If we are deemed to be a PRC resident enterprise, the withholding tax may be exempted, but in such a case we will be subject to a 25% tax on our global income, and our non-PRC investors may be subject to PRC income tax withholding. For a more detailed discussion of the New EIT Law, see Item 10 - Additional Information, Subpart E, Taxation in China of this Form 20-F.

For the Singapore and Malaysia subsidiaries, each of them may pay dividends only out of its profits based on the articles of association and the Companies Act in Singapore and Malaysia. There is no limit to the amount of dividend payable as long as there are sufficient profits. There is no withholding tax imposed on a Singapore and Malaysia company paying dividends to a company located outside of Singapore and Malaysia upon remittance.

**B. Significant Changes**

None.

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**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

We have elected to provide financial statements pursuant to Item 18.

**ITEM 18. FINANCIAL STATEMENTS**

Our Audited Financial Statements for the Years Ended June 30, 2015, 2014 and 2013 are included at the end of this annual report.

**ITEM 19. EXHIBITS**

**Number Description**

- |     |  |
|-----|--|
| 1.1 | Memorandum of Association of Registrant (Incorporated by reference to Annex B of the Proxy Statement/Prospectus contained in Registration Statement S-4 (file no. 333-132826) filed with the Securities and Exchange Commission on March 30, 2006).  |
| 1.2 | Articles of Association of Registrant (Incorporated by reference to Annex C of the Proxy Statement/Prospectus contained in Registration Statement S-4 (file no. 333-132826) filed with the Securities and Exchange Commission on March 30, 2006).  |
| 1.3 | Certificate of Change of Name (Incorporated by reference to Exhibit 1.3 of the Form 20-F filed with the Securities and Exchange Commission on September 30, 2009).   |
| 1.4 | Amendment to Memorandum and Articles of Association of Hollysys Automation Technologies Ltd. (Incorporated by reference to Exhibit 1.1 of the Form 6-K filed with the Securities and Exchange Commission on September 21, 2010).   |
| 2.1 | Rights Agreement, dated as of August 27, 2010, between Hollysys Automation Technologies Ltd. and Continental Stock Transfer & Trust Company, which includes the Form of Right Certificate as Exhibit A and the Summary of Rights to Purchase Preferred Shares as Exhibit B (Incorporated by reference to Exhibit 2.1 of the Form 6-K filed with the Securities and Exchange Commission on September 21, 2010). |



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- Chardan North China Acquisition Corporation 2006 Stock Plan (Incorporated by reference to Exhibit 4.1 of the
- 4.1 Registration Statement on Form S-8 (file no. 333-170811) filed with the Securities and Exchange Commission on November 24, 2010).
- 4.2 Form of Stock Consignment Agreement (Incorporated by reference to Exhibit 10.2 of the Registration Statement S-4/A (file no. 333-132826) filed with the Securities and Exchange Commission on June 28, 2006).
- 4.3 Share Sale and Purchase Agreement, by Unionway Resources Limited and the Company, dated December 23, 2009. ((Incorporated by reference to Exhibit 4.20 of the Report on Form 20-F for the fiscal year ended June 30, 2010 filed with the Securities and Exchange Commission on December 22, 2010).
- 4.4 Retrofit Contract between Concord Corporation Pte. Led. and Shaw Brothers Limited (Incorporated by reference to Exhibit 99.1 of the Form 6-K filed with the Securities and Exchange Commission on March 7, 2012).
- 8.1 List of Subsidiaries (Incorporated by reference to Exhibit 8.1 of the Annual Report on Form 20-F for the fiscal year ended June 30, 2015 filed with the Securities and Exchange Commission on September 25, 2015).
- 11.1 Code of Ethics (included as Annex G to the Proxy Statement/Prospectus contained in Registration Statement 333-132826 and incorporated by reference herein)
- 12.1\* CEO Certification Pursuant to Rule 13a-14(a) (17 CFR 240.13a-14(a)) (17 CFR 240.13a-14(a)) or Rule 15d-1(a) (17 CFR 240.15d-14(a))
- 12.2\* CFO Certification Pursuant to Rule 13a-14(a) (17 CFR 240.13a-14(a)) or Rule 15d-1(a) (17 CFR 240.15d-14(a))
- 13.1\* CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 13.2\* CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 15.1\* Consent of Ernst and Young Hua Ming LLP
- 101.INS\* XBRL Instant Document
- 101.SCH\* XBRL Taxonomy Extension Schema Document
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase

\* Filed with this annual report on Form 20-F/A



**SIGNATURE**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this amended annual report on its behalf.

**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.**

/s/ Baiqing Shao  
Baiqing Shao

Date: March 8, 2016 Chief Executive Officer

**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of Hollysys Automation Technologies Ltd.

We have audited the accompanying consolidated balance sheets of Hollysys Automation Technologies Ltd. (the “Company”) as of June 30, 2015 and 2014, and the related consolidated statements of comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended June 30, 2015. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hollysys Automation Technologies Ltd. at June 30, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 30, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Hollysys Automation Technologies Ltd.’s internal control over financial reporting as of June 30, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated September 25, 2015, expressed an unqualified opinion thereon.

/s/ Ernst & Young Hua Ming LLP

Beijing, the People’s Republic of China

September 25, 2015

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## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of Hollysys Automation Technologies Ltd.

We have audited Hollysys Automation Technologies Ltd.'s internal control over financial reporting as of June 30, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the "COSO criteria"). Hollysys Automation Technologies Ltd.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, Hollysys Automation Technologies Ltd. maintained, in all material respects, effective internal control over financial reporting as of June 30, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Hollysys Automation Technologies Ltd. as of June 30, 2015 and 2014, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2015 of Hollysys Automation Technologies Ltd. and our report dated September 25, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young Hua Ming LLP

Beijing, the People's Republic of China

September 25, 2015

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**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
(In US dollars thousands except for number of shares and per share data)

	Notes	June 30, 2014	2015
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents		\$162,159	\$207,834
Time deposits with maturities over three months		28,334	49,650
Restricted cash		8,359	25,337
Accounts receivable, net of allowance for doubtful accounts of \$25,691 and \$34,259 as of June 30, 2014 and 2015, respectively	5	258,885	252,538
Costs and estimated earnings in excess of billings, net of allowance for doubtful accounts of \$5,839 and \$8,850 as of June 30, 2014 and 2015, respectively	6	179,688	165,337
Other receivables, net of allowance for doubtful accounts of \$334 and \$638 as of June 30, 2014 and 2015, respectively		11,039	12,471
Advances to suppliers		11,588	15,286
Amounts due from related parties	22	23,720	39,077
Inventories	4	35,053	34,706
Prepaid expenses		868	594
Income tax recoverable		666	596
Deferred tax assets	20	6,687	3,214
Assets held for sale	9	2,847	-
Total current assets		729,893	806,640
Non-current assets:			
Restricted cash		7,498	3,994
Prepaid expenses		108	13
Property, plant and equipment, net	7	82,345	80,222
Prepaid land leases	8	12,397	11,649
Acquired intangible assets, net	10	6,510	1,693
Investments in equity investees	12	15,062	12,512
Investments in cost investees	12	4,436	4,464
Goodwill	11	66,640	59,918
Deferred tax assets	20	1,806	2,581
Total non-current assets		196,802	177,046
Total assets		\$926,695	\$983,686
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Short-term bank loans	14	\$4,494	\$16,295
Current portion of long-term loans	15	8,517	14,111
Accounts payable		135,669	105,292

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Construction costs payable		4,903	1,159
Deferred revenue		130,696	138,587
Accrued payroll and related expenses		10,601	11,982
Income tax payable	20	12,040	5,732
Warranty liabilities	13	4,014	7,310
Other tax payables		27,631	20,147
Accrued liabilities		24,426	31,299
Amounts due to related parties	22	3,988	1,713
Deferred tax liabilities	20	1,627	5,888
Current portion of acquisition-related consideration		30,285	15,081
Total current liabilities		398,891	374,596
Long-term loans	15	14,978	20,551
Deferred tax liabilities	20	2,371	77
Warranty liabilities		3,604	3,077
Non-current portion of acquisition-related consideration		14,793	-
Total non-current liabilities		35,746	23,705
Total liabilities		434,637	398,301
Commitments and contingencies	23	-	-
Stockholders' equity:			
Ordinary shares, par value \$0.001 per share, 100,000,000 shares authorized; 58,358,521 shares issued and outstanding	17	58	58
Additional paid-in capital		173,765	192,768
Statutory reserves		23,288	30,248
Retained earnings		252,351	318,441
Accumulated other comprehensive income		39,013	37,585
Total Hollysys Automation Technologies Ltd. stockholder's equity		488,475	579,100
Noncontrolling interests		3,583	6,285
Total equity		492,058	585,385
Total liabilities and equity		\$926,695	\$983,686

**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In US dollars thousands except for number of shares and per share data)

	Notes	Year ended June 30,		
		2013	2014	2015
Net revenues				
Integrated contract revenue (including revenue from related parties of \$18,473, \$4,659 and \$22,544 for the years ended June 30, 2013, 2014 and 2015, respectively)		\$328,551	478,261	\$481,006
Product sales (including revenue from related parties of \$1,084, \$1,629 and \$2,014 for the years ended June 30, 2013, 2014 and 2015, respectively)		20,504	31,922	39,762
Revenue from services (including revenue from related parties of nil, \$497 and \$19 for the years ended June 30, 2013, 2014 and 2015, respectively)		-	11,149	10,611
Total net revenues		349,055	521,332	531,379
Costs of integrated contracts (including purchases from related parties of \$527, \$364 and \$419 for the years ended June 30, 2013, 2014 and 2015 respectively)		218,586	330,039	300,332
Costs of products sold		6,800	11,580	12,547
Costs of services rendered		-	4,090	4,098
Gross profit		123,669	175,623	214,402
Operating expenses				
Selling (including expenses from related parties of \$949, \$1,953 and \$914 for the years ended June 30, 2013, 2014 and 2015 respectively)		26,794	28,258	26,263
General and administrative		29,648	39,716	50,786
Goodwill impairment charge		-	-	1,855
Research and development		32,507	36,486	35,779
VAT refunds and government subsidies		(22,982)	(27,244)	(30,388)
Total operating expenses		65,967	77,216	84,295
Income from operations		57,702	98,407	130,107
Other income (expenses), net (including other income from related parties of \$66, \$65 and \$41 for the years ended June 30, 2012, 2013 and 2014, respectively)		80	(6,452)	2,601
Foreign exchange gain (loss)		800	794	(6,765)
Gain on disposal of an equity investee		-	-	80
Share of net income (losses) of equity investees		297	(2,692)	(2,910)
Interest income		3,075	3,253	3,686
Interest expenses		(2,170)	(1,998)	(1,821)

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Dividend income from cost investees		834	-	249
Income before income taxes		60,618	91,312	125,227
Income tax expenses	20	8,097	19,861	26,040
Net income		52,521	71,451	99,187
Less: net income attributable to noncontrolling interests		527	1,831	2,660
<b>Net income attributable to Hollysys Automation Technologies Ltd.</b>		<b>\$51,994</b>	<b>69,620</b>	<b>\$96,527</b>
Other comprehensive income, net of tax of nil				
Translation adjustments		\$4,193	2,146	\$(1,386 )
Comprehensive income		56,714	73,597	97,801
Less: comprehensive income attributable to noncontrolling interests		563	1,837	2,701
<b>Comprehensive income attributable to Hollysys Automation Technologies Ltd.</b>		<b>\$56,151</b>	<b>71,760</b>	<b>\$95,100</b>
Net income per share:				
Basic	21	\$0.93	\$1.20	\$1.65
Diluted	21	\$0.92	\$1.19	\$1.61
Shares used in income per share computation:				
Weighted average number of ordinary shares		56,167,592	57,926,333	58,612,596
Weighted average number of diluted ordinary shares		56,412,469	58,426,642	60,134,203

*See accompanying notes to consolidated financial statements*

**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In US dollars thousands)**

	Year ended June 30,		
	2013	2014	2015
Cash flows from operating activities:			
Net income	\$52,521	\$71,451	\$99,187
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property, plant and equipment	6,224	7,051	8,508
Amortization of prepaid land leases	158	245	197
Amortization of intangible assets	2,848	5,413	4,454
Allowance for doubtful accounts	6,342	10,545	17,418
(Gain) loss on disposal of property, plant and equipment	(97 )	(132 )	598
Impairment loss on share of a cost investment	-	325	-
Goodwill impairment charge	-	-	1,855
Share of net (income) losses of equity investees	(297 )	2,692	2,910
Dividends received from a cost investee	(834 )	-	(249 )
Gain on disposal of investment in an equity investee	-	-	(80 )
Gain on disposal of a subsidiary	(6 )	-	-
Share-based compensation expenses	1,599	2,986	2,492
Deferred income tax (benefit) expenses	(1,956 )	(5,427 )	4,846
Acquisition-related consideration adjustments	1,163	8,920	(166 )
Accretion of convertible bond discount	-	-	192
Fair value adjustments of a bifurcated derivative	-	-	35
Changes in operating assets and liabilities:			
Accounts receivable	(33,423 )	(88,593 )	(7,675 )
Costs and estimated earnings in excess of billings	(19,956 )	(38,810 )	10,527
Inventories	(6,673 )	(806 )	560
Advances to suppliers	2,054	(2,959 )	(3,690 )
Other receivables	(3,433 )	697	(1,928 )
Deposits and other assets	(4,857 )	(5,142 )	(13,375 )
Due from related parties	(11,673 )	2,776	(15,205 )
Accounts payable	22,435	24,161	(25,836 )
Deferred revenue	4,140	63,348	7,556
Accruals and other payable	11,040	7,979	6,897
Cash dividends received from equity investees	-	2,408	-
Due to related parties	58	1,899	(2,301 )
Income tax payable	54	6,762	(6,153 )
Other tax payables	3,246	5,489	(7,622 )
<b>Net cash provided by operating activities</b>	<b>\$30,677</b>	<b>\$83,278</b>	<b>\$83,952</b>
Cash flows from investing activities:			

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Time deposits placed with banks	(19,592 )	(18,881 )	(33,416 )
Purchases of property, plant and equipment	(9,088 )	(8,359 )	(4,553 )
Proceeds from disposal of investment in an equity investee	-	-	80
Maturity of time deposits	28,069	11,588	11,551
Proceeds from disposal of property, plant and equipment	334	866	794
Cash contributions to an equity investee	-	(3,904 )	-
Cash contributions to a cost investee	-	(1,030 )	-
Acquisition of a subsidiary, net of cash acquired	(11,937 )	(5,510 )	(14,600 )
Dividends received from a cost investee	-	-	249
Proceeds from disposal of a subsidiary	113	-	-
Net cash used in investing activities	(12,101 )	(25,230 )	(39,895 )
Cash flows from financing activities:			
Proceeds from short-term bank loans	\$7,499	\$14,583	\$25,074
Repayments of short-term bank loans	(4,555 )	(13,826 )	(12,631 )
Proceeds from long-term bank loans	611	108	-
Repayments of long-term bank loans	(8,237 )	(9,192 )	(8,813 )
Proceeds from convertible bond	-	-	20,000
Convertible bond issuance cost	-	-	(349 )
Proceeds from exercise of options	967	-	1,280
Payment of dividends	-	-	(23,300 )
Net cash (used in) provided by financing activities	(3,715 )	(8,327 )	1,261
Effect of foreign exchange rate changes	1,035	209	357
<b>Net increase in cash and cash equivalents</b>	<b>\$15,896</b>	<b>\$49,930</b>	<b>\$45,675</b>
Cash and cash equivalents, beginning of year	96,333	112,229	162,159
Cash and cash equivalents, end of year	<b>\$112,229</b>	<b>\$162,159</b>	<b>\$207,834</b>
Supplementary disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$2,087	\$1,842	\$1,855
Income tax	\$10,024	\$17,613	\$26,183
Supplementary disclosures of significant non-cash transactions:			
Acquisition of property, plant and equipment included in construction costs payable and accrued liabilities	\$6,764	\$1,989	\$484
Issuance of ordinary shares as purchase consideration in connection with the acquisition of Bond	\$16,910	\$-	\$15,231

*See accompanying notes to consolidated financial statements.*

**HOLLYSYS AUTOMATION TECHNOLOGIES LTD.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(In US dollars thousands except for number of shares)

	Ordinary shares	Additional paid-in	Statutory reserves	Retained earnings	Accumulated other comprehensive income	Total Hollysys Automation Technologies Ltd. stockholders' equity	Noncontrolling interest	Total equity	
	Shares	Amount	capital	reserves	earnings	income	stockholders' equity	equity	
<b>Balance at June 30, 2012</b>	<b>55,998,917</b>	<b>\$ 56</b>	<b>\$ 151,305</b>	<b>\$ 23,091</b>	<b>\$ 130,934</b>	<b>\$ 32,715</b>	<b>\$ 338,101</b>	<b>\$ 1,184</b>	<b>\$ 339,285</b>
Share-based compensation	-	-	1,599	-	-	-	1,599	-	1,599
Issuance of ordinary shares upon exercise of options	138,000	-	967	-	-	-	967	-	967
Exercise of share-based compensation on restricted shares issued to directors	10,000	-	-	-	-	-	-	-	-
Acquisition of a subsidiary (Note 3)	1,407,907	2	16,908	-	-	-	16,910	-	16,910
Net income for the year	-	-	-	-	51,994	-	51,994	527	52,521
Appropriations to statutory reserves	-	-	-	55	(55 )	-	-	-	-
Translation adjustments	-	-	-	-	-	4,157	4,157	36	4,193
<b>Balance at June 30, 2013</b>	<b>57,554,824</b>	<b>\$ 58</b>	<b>\$ 170,779</b>	<b>\$ 23,146</b>	<b>\$ 182,873</b>	<b>\$ 36,872</b>	<b>\$ 413,728</b>	<b>\$ 1,747</b>	<b>\$ 415,475</b>
Share-based compensation	-	-	2,986	-	-	-	2,986	-	2,986
Net income for the year	-	-	-	-	69,620	-	69,620	1,831	71,451
Appropriations to statutory reserves	-	-	-	142	(142 )	-	-	-	-
	-	-	-	-	-	2,141	2,141	5	2,146

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Translation adjustments									
<b>Balance at June 30, 2014</b>	<b>57,554,824</b>	<b>\$ 58</b>	<b>\$173,765</b>	<b>\$23,288</b>	<b>\$252,351</b>	<b>\$ 39,013</b>	<b>\$ 488,475</b>	<b>\$ 3,583</b>	<b>\$492,058</b>
Share-based compensation	-	-	2,492	-	-	-	2,492	-	2,492
Issuance of ordinary shares upon exercise of options	142,500	- *	1,280	-	-	-	1,280	-	1,280
Exercise of share-based compensation on restricted shares issued to directors	12,500	- *	-	-	-	-	-	-	-
Issuance of Incentive Shares and Premium Shares for Bond (Note 3)	648,697	- *	15,231	-	-	-	15,231	-	15,231
Net income for the year	-	-	-	-	96,527	-	96,527	2,660	99,187
Appropriations to statutory reserves	-	-	-	7,137	(7,137 )	-	-	-	-
Dividend paid	-	-	-	-	(23,300 )	-	(23,300 )	-	(23,300 )
Other	-	-	-	(177 )	-	-	(177 )	-	(177 )
Translation adjustments	-	-	-	-	-	(1,428 )	(1,428 )	42	(1,386 )
<b>Balance at June 30, 2015</b>	<b>58,358,521</b>	<b>\$ 58</b>	<b>\$192,768</b>	<b>\$30,248</b>	<b>\$318,441</b>	<b>\$ 37,585</b>	<b>\$ 579,100</b>	<b>\$ 6,285</b>	<b>\$585,385</b>

\* The share capital increase for the issuance of ordinary shares upon exercise of options, restricted share and Incentive and Premium Shares for Bond are less than \$1.

*See accompanying notes to consolidated financial statements.*



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015**

**(Amounts in thousands except for number of shares and per share data)**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - ORGANIZATION AND BUSINESS BACKGROUND**

Hollysys Automation Technologies Ltd. (“Hollysys” or the “Company”), formerly known as HLS Systems International Ltd., was established under the laws of the British Virgin Islands (“BVI”) on February 6, 2006, for the purpose of merging with Chardan North China Acquisition Corporation (“Chardan”), a blank check company incorporated in Delaware, United States of America, and to hold 100% interest in Gifted Time Holdings Limited (“GTH”) upon the completion of a share exchange transaction (the “Share Exchange Transaction”). GTH was established under the laws of the BVI on September 21, 2005 and was the holding company of Beijing Hollysys Co., Ltd. (“Beijing Hollysys”) and Hangzhou Hollysys Automation Co., Ltd. (“Hangzhou Hollysys”) through a reorganization arrangement with equity interests of 74.11% and 60%, respectively.

On September 7, 2007, the shareholders of Chardan approved the Share Exchange Transaction. As a result, Chardan merged with and into Hollysys to complete the re-domestication merger and Hollysys consummated the Share Exchange Transaction with GTH. Upon completion of the Share Exchange Transaction, Hollysys owned 100% interest in GTH, which held 74.11% equity interest of Beijing Hollysys and 60% equity interest of Hangzhou Hollysys. Beijing Hollysys held the remaining 40% equity interest of Hangzhou Hollysys.

On July 1, 2009, the Company acquired 1.78% equity interest in Beijing Hollysys from the noncontrolling shareholders for a consideration of RMB18,000 (approximately \$2,639). Upon completion of the acquisition, the Company held a 75.89% equity interest in Beijing Hollysys.

On December 23, 2009, the Company entered into a share sale and purchase agreement with Unionway Resources Limited (“Unionway”), a company incorporated in the BVI, pursuant to which, among other things, the Company acquired 24.11% equity interest of Beijing Hollysys. As the consideration for the acquisition, the Company paid

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RMB67,634 (\$9,917) in cash and issued 4,413,948 ordinary shares, with total fair value of \$53,012, to Unionway on March 16, 2010. Upon completion of the acquisition, the Company indirectly owns 100% of Beijing Hollysys.

On July 1, 2011, the Company acquired 100% equity interest of Concord Corporation Pte. Ltd. (including Concord Corporation Pte. Ltd., Dubai branch) and its subsidiaries, Concord Electrical Pte. Ltd., and Concord Electrical Sdn. Bhd. (collectively, "Concord"). Concord is a Singapore headquartered integrated construction and installation services provider to rail and industrial companies in Southeast Asia and the Middle East.

On May 9, 2012, Concord Solution (HK) Limited was established to provide integrated automation products and services. It is 100% indirectly owned by the Company with a registered capital of HKD10.

On July 24, 2012, Hangzhou Hollysys System Engineering Co., Ltd. was established to provide integrated automation products and services. It is 100% indirectly owned by the Company with a registered capital of RMB50,000.

In December 2012, the Company disposed of its 51% equity interest in Beijing WoDeWeiYe Technology Exploration Co., Ltd. ("WoDeWeiYe") for a consideration of \$113. WoDeWeiYe was insignificant to the Company and thus the results of WoDeWeiYe were not presented as discontinued operations.

**Year ended June 30,  
2013**

Net revenues	\$	49	
Net income (loss)	\$	(33	)

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

On January 10, 2013, Hollysys International Pte. Ltd. was established under the law of Singapore for the purpose of acquiring Bond Corporation Pte. Ltd. It is 100% owned by the Company with a registered capital of SGD20,000.

On February 21, 2013, Concord M Design and Engineering Company Limited were established to undertake potential projects in Macau. It is 100% indirectly owned by the Company with a registered capital of 25 Macau Pataca.

On April 1, 2013, the Company acquired 100% equity interest of Bond Corporation Pte. Ltd. and its subsidiaries, Bond M & E Sdn. Bhd., Bond M & E (KL) Sdn. Bhd. and Bond M & E Pte. Ltd. (collectively, “Bond”). Bond is a Singapore headquartered mechanical and electrical solutions service provider for building construction and renovation projects in Malaysia and Singapore.

On March 31, 2014, Hollysys Automation India Private Limited (“HAIP”) was established as part of the effort the Company made to increase its presence and explore the market in India. HAIP mainly provides integrated solution products to the customers.

On December 15, 2014, Hollycon (Italy) Pte. Ltd. (“Hollycon Italy”) was established as part of the effort the Company made to explore the oversea market. The newly setup subsidiary mainly manufactures and sells medical automation equipment.

On January 31, 2015, the Company liquidated HaoTong, which is a subsidiary 100% indirectly owned by the Company. HaoTong was insignificant to the Company and thus the results of HaoTong were not presented as discontinued operations.

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As of June 30, 2015, details of the Company's subsidiaries are as follows:

Name of company	Place of incorporation	Date of incorporation	Percentage of ownership interest attributable to the Company		Principal activities
			Directly	Indirectly	
Gifted Time Holdings Limited ("GTH")	BVI	September 21, 2005	100 %	-	Investment holding
Clear Mind Limited ("Clear Mind")	BVI	November 29, 2007	-	100 %	Investment holding
World Hope Enterprises Limited ("World Hope")	Hong Kong	September 17, 2007	-	100 %	Investment holding
Beijing Helitong Science & Technology Exploration Co., Ltd. ("Helitong")	The People's Republic of China ("PRC")	January 25, 2008	-	100 %	Investment holding
Hollysys Group Co., Ltd. ("Hollysys Group")	PRC	December 17, 2007	-	100 %	Investment holding
Hollysys (Beijing) Investment Co., Ltd. ("Hollysys Investment")	PRC	April 15, 2011	-	100 %	Investment management
Beijing Hollysys Automation & Drive Co., Ltd. ("Hollysys A&D")	PRC	May 13, 2008	-	100 %	Provision of integrated automation products and services
Hangzhou Hollysys Automation Co., Ltd. ("Hangzhou Hollysys")	PRC	September 24, 2003	-	100 %	Provision of integrated automation products and services
Hangzhou Hollysys System Engineering Co., Ltd. ("Hangzhou System")	PRC	July 24, 2012	-	100 %	Provision of integrated automation products and services
Beijing Hollysys Electronics Technology Co., Ltd. ("Hollysys Electronics")	PRC	June 4, 2010	-	100 %	Manufacture components of automation products for members of Hollysys
Beijing Hollycon Medicine & Technology Co., Ltd. ("Hollycon")	PRC	June 4, 2010	-	51 %	Manufacture and sale of medical automation equipment

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Beijing Hollysys Co., Ltd. ("Beijing Hollysys")	PRC	September 25, 1996	-	100	%	Provision of integrated automation products and services
Xi'an Hollysys Co., Ltd. ("Xi'an Hollysys")	PRC	March 9, 2011	-	100	%	Research and development
Hollysys International Pte. Limited ("HI")	Singapore	January 10, 2013	100	%	-	Investment holding
Hollycon (Italy) Pte. Ltd. ("Hollycon Italy")	Italy	December 15, 2014	-	99	%	Manufacture and sale of medical automation equipment
Hollysys (Asia Pacific) Pte. Limited ("HAP")	Singapore	October 23, 1997	-	100	%	Provision of integrated automation products and services
Hollysys Automation India Private Limited ("HAIP")	India	March 31, 2014	-	100	%	Provision of automation products
Concord Corporation Pte. Ltd. ("CCPL")	Singapore	March 10, 2008	-	100	%	Provision of mechanical and electrical solutions and installation services
Concord Electrical Pte. Ltd. ("CEPL")	Singapore	May 25, 1984	-	100	%	Provision of mechanical and electrical solutions and installation services
Concord Electrical Sdn. Bhd. ("CESB")	Malaysia	May 13, 1994	-	100	%	Provision of mechanical and electrical solutions and installation services
Concord Solution (HK) Limited ("CSHK")	Hong Kong	May 9, 2012	-	100	%	Provision of mechanical and electrical solutions and installation services
Concord M Design and Engineering Company Limited ("CMDE")	Macau	February 21, 2013	-	100	%	Provision of mechanical and electrical solutions and installation services
Bond Corporation Pte. Ltd. ("BCPL")	Singapore	November 1, 2012	-	100	%	Investment holding
Bond M & E Pte. Ltd. ("BMSG")	Singapore	March 6, 1981	-	100	%	Provision of mechanical and electrical solutions and installation services
	Malaysia	October 25, 1983	-	100	%	

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Bond M & E Sdn. Bhd. ("BMJB")						Provision of mechanical and electrical solutions and installation services
Bond M & E (KL) Sdn. Bhd. ("BMKL")	Malaysia	October 24, 1989	-	100	%	Provision of mechanical and electrical solutions and installation services

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

The Company is principally engaged in the manufacture, sale and provision of integrated automation systems and services, mechanical and electrical solution services and installation services in the PRC, Hong Kong, Southeast Asia and the Middle East through its operating subsidiaries.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of consolidation and basis of presentation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company transactions and balances are eliminated upon consolidation. The consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America (“U.S. GAAP”).

**Use of estimates**

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management evaluates estimates, including those related to the expected total costs of integrated contracts, expected gross margins of integrated solution contracts, allowance for doubtful accounts, fair values of share options, fair value of bifurcated derivative, purchase price allocation and contingent consideration with respect to business combinations, warranties, valuation allowance of deferred tax assets and impairment of goodwill and other long-lived assets. Management bases the estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ materially from those estimates.

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

**Foreign currency translations and transactions**

The Company, GTH, Clear Mind and World Hope's functional currency is the United States dollars ("US dollars" or "\$"); whereas the Company's subsidiaries use the primary currency of the economic environment in which their operations are conducted as their functional currency. Renminbi ("RMB") is determined to be the functional currency of all PRC subsidiaries; Singapore dollar ("SGD") is determined to be the functional currency of HI, HAP, CCPL, CEPL, BCPL and BMSG; Malaysian Ringgit ("MYR") is determined to be the functional currency of CESB, BMJB and BMKL; and United Arab Emirates Dirham ("AED"), Hong Kong dollar ("HKD"), Macau Pataca ("MOP"), Indian Rupee ("INR") and Euro ("EUR") are the functional currencies of CCPL Dubai, CSHK, CMDE, HAIP and Hollycon Italy, respectively. The Company uses the US dollars as its reporting currency.

The Company translates the assets and liabilities into US dollars using the rate of exchange prevailing at the balance sheet date, and the statements of comprehensive income are translated at average rates during the reporting period. Adjustments resulting from the translation of financial statements from the functional currency into US dollars are recorded in stockholders' equity as part of accumulated other comprehensive income. Transactions dominated in currencies other than the functional currency are translated into functional currency at the exchange rates prevailing on the transaction dates, and the exchange gains or losses are reflected in the consolidated statements of comprehensive income for the reporting period.

Transactions denominated in foreign currencies are measured into the functional currency at the exchange rates prevailing on the transaction dates. Foreign currency denominated financial assets and liabilities are re-measured at the exchange rates prevailing at the balance sheet date. Exchange gains and losses are included in earnings, except for those raised from intercompany transactions with investment nature, which are recorded in other comprehensive income.

For the years ended June 30, 2013, 2014 and 2015, the Company recorded foreign exchange gain (loss), net of \$800, \$794 and \$(6,765), respectively.

## **Business combinations**

The Company accounts for its business combinations using the purchase method of accounting in accordance with Accounting Standards Codification (“ASC”) Topic 805, *Business Combinations* (“ASC 805”). The purchase method of accounting requires that the consideration transferred to be allocated to the assets, including separately identifiable assets and liabilities the Company acquired based on their estimated fair values. The consideration transferred of an acquisition is measured as the aggregate of the fair values at the date of exchange of the assets given, liabilities incurred, and equity instruments issued as well as the contingent considerations and all contractual contingencies as of the acquisition date. Identifiable assets, liabilities and contingent liabilities acquired or assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any noncontrolling interests. The excess of (i) the total cost of the acquisition, fair value of the noncontrolling interests and acquisition date fair value of any previously held equity interest in the acquiree over (ii) the fair value of the identifiable net assets of the acquiree, is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statements of comprehensive income.

The determination and allocation of fair values to the identifiable assets acquired, liabilities assumed and noncontrolling interests is based on various assumptions and valuation methodologies requiring considerable management judgment. The most significant variables in these valuations are discount rates, terminal values, as well as the assumptions and estimates used to determine the cash inflows and outflows. The Company determines discount rates to be used based on the risk inherent in the related activity’s current business model and industry comparisons. Terminal values are based on the expected life of assets and forecasted cash flows over that period.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Acquisition-related costs are recognized as general and administrative expenses in the statements of comprehensive income as incurred.

**Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand and bank deposits, which are unrestricted as to withdrawal and use. All highly liquid investments that are readily convertible to known amounts of cash with original stated maturities of three months or less are classified as cash equivalents.

**Time deposits with original maturities over three months**

Time deposits with original maturities over three months consist of deposits placed with financial institutions with original maturity terms from four months to one year. As of June 30, 2015, \$29,051, \$14,721 and \$5,878 of time deposits with original maturities over three months were placed in financial institutions in the PRC, Singapore and Malaysia, respectively. As of June 30, 2014, \$17,100 and \$11,234 time deposits with original maturities over three months were placed in financial institutions in the PRC and Malaysia, respectively.

**Restricted cash**

Restricted cash mainly consists of the cash deposited in banks pledged for performance guarantees, or bank loans. These cash balances are not available for use until these guarantees are expired or cancelled, or the loans are repaid.

## Revenue recognition

### Integrated solutions contracts

Revenues generated from designing, building, and delivering customized integrated industrial automation systems are recognized over the contractual terms based on the percentage of completion method. The contracts for designing, building, and delivering customized integrated industrial automation systems are legally enforceable binding agreements between the Company and customers. The duration of contracts depends on the contract size and ranges from 6 months to 5 years excluding the warranty period. The majority of the contract duration is longer than one year.

Revenue generated from mechanical and electrical solution contracts for the construction or renovation of buildings, rail or infrastructure facilities are also recognized over the contractual terms based on the percentage of completion method. The contracts for mechanical and electrical solution services are legally enforceable binding agreements between the Company and customers. The duration of contracts depends on the contract size and the complexity of the construction work and ranges from 6 months to 3 years excluding the warranty period. The majority of the contract duration is longer than one year.

In accordance with ASC 605-35, *Revenue Recognition - Construction-Type and Production-Type Contracts* (“ASC 605-35”), recognition is based on an estimate of the income earned to date, less income recognized in earlier periods. Revisions in the estimated total costs of integrated contracts are made in the period in which the circumstances requiring the revision become known. Provisions, if any, are made in the period when anticipated losses are expected on uncompleted contracts.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

The Company reviews and updates the estimated total costs of integrated solution contracts at least semi-annually. The Company accounts for revisions to contract revenue and estimated total costs of integrated solution contracts, including the impact due to approved change orders, in the period in which the facts that cause the revision become known as changes in estimates. Unapproved change orders are considered claims. Claims are recognized only when it has been awarded by customers. Excluding the impact of change orders, if the estimated total costs of integrated solution contracts, which were revised during the years ended June 30, 2013, 2014 and 2015, had been used as a basis of recognition of integrated contract revenue since the contract commencement, net income for the years ended June 30, 2013, 2014 and 2015 would have been decreased by \$11,253, \$4,436, and \$26,232, respectively; basic net income per share for years ended June 30, 2013, 2014 and 2015 would have been decreased by \$0.20, \$0.08, and \$0.45, respectively; and diluted net income per share for the years ended June 30, 2013, 2014 and 2015, would have decreased by \$0.20, \$0.08, and \$0.44, respectively. Revisions to the estimated total costs for the years ended June 30, 2013, 2014 and 2015 were made in the ordinary course of business.

The Company combines a group of contracts as one project if they are closely related and are, in substance, parts of a single project with an overall profit margin. The Company segments a contract into several projects, when they are of different business substance, for example, with different business negotiation, solutions, implementation plans and margins.

Revenue in excess of billings on the contracts is recorded as costs and estimated earnings in excess of billings. Billings in excess of revenues recognized on the contracts are recorded as deferred revenue until the above revenue recognition criteria are met.

The Company generally recognizes 100% of the contractual revenue when the customer acceptance has been obtained, and no further major costs are estimated to be incurred, normally this is also when the warranty period commences. Revenues are presented net of taxes collected on behalf of the government.

Product sales

Revenue generated from sales of products is recognized when the following four revenue recognition criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the selling price is fixed or determinable, and (iv) collectability is reasonably assured.

### Service rendered

The Company has in recent years extended its service offerings as described below. The Company mainly provides two types of services:

Revenue from one-off services: the Company provides different types of one-off services, including on-site maintenance service and training services which are generally completed on site within a few working days. Revenue is recognized when the Company has completed all the respective services described in the contracts, there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection is reasonably assured.

Revenue from services covering a period of time: the Company also separately sells extended warranties to their integrated solution customers for a fixed period. Such arrangements are negotiated separately from the corresponding integrated solution system and are usually entered into upon the expiration of the warranty period attached to the integrated solution contract. During the extended warranty period, the Company is responsible for addressing issues related to the system. Part replacement is not covered in such services. The Company recognizes revenue on a pro-rata basis over the contractual term.

Revenue from services was not presented separately in the consolidated statement of comprehensive income for the fiscal year ended June 30, 2013 as the amounts was immaterial.

### **Inventories**

Inventories are composed of raw materials, work in progress, purchased and manufactured finished goods and low value consumables. Inventories are accounted for on the “first-in, first-out basis”, and stated at the lower of cost or market.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

The Company assesses the lower of cost or market for non-saleable, excess or obsolete inventories based on its periodic review of inventory quantities on hand and the latest forecasts of product demand and production requirements from its customers. The Company writes down inventories for non-saleable, excess or obsolete raw materials, work-in-process and finished goods by charging such write-downs to cost of integrated contracts and/or costs of products sold.

**Warranties**

Warranties represent a major term under an integrated contract, which will last, in general, for one to three years or otherwise specified in the terms of the contract. The Company accrues warranty liabilities under an integrated contract as a percentage of revenue recognized, which is derived from its historical experience, in order to recognize the warranty cost for an integrated contract throughout the contract period. In addition, the Company estimates whether or not the accrued warranty liabilities are adequate by considering specific conditions that may arise and the number of contracts under warranty period at each reporting date. The Company adjusts the accrued warranty liabilities in line with the results of its assessment.

**Accounts receivable and costs and estimated earnings in excess of billings**

Performance of the integrated contracts will often extend over long periods and the Company's right to receive payments depends on its performance in accordance with the contractual agreements. There are different billing practices in the PRC and overseas operating subsidiaries including Concord and Bond. For the Company's PRC subsidiaries, billings are issued based on milestones specified in contracts negotiated with customers. In general, there are four milestones: 1) project commencement, 2) system manufacturing and delivery, 3) installation, trial-run and customer acceptance, and 4) expiration of the warranty period. The amounts to be billed at each milestone are specified in the contract. All contracts have the first milestone, but not all contracts require prepayments. The length of each interval between two continuous billings under an integrated contract varies depending on the duration of the contract (under certain contracts, the interval lasts more than a year) and the last billing to be issued for an integrated

solution contract is scheduled at the end of a warranty period. For Concord and Bond, billing claims rendered are subject to the further approval and certification of the customers or their designated consultants. Payments are made to Concord or Bond based on the certified billings according to the payment terms mutually agreed between the customers and Concord or Bond. Certain amounts are retained by the customer and payable to Concord and Bond upon satisfaction of final quality inspection or at the end of the warranty period. The retained amounts which were recorded as accounts receivables were \$6,549, \$9,653 and \$10,380 for the three years ended June 30, 2013, 2014 and 2015, respectively. Prepayments received are recorded as deferred revenue. The deferred revenue will be recognized as revenue under the percentage of completion method along with the progress of a contract. If no prepayment is received by the Company, revenue will be recognized through costs and estimated earnings in excess of billings.

The Company does not require collateral from its customers. Based on the prevailing collection practices in China, it is a reasonable expectation for the enterprises in the automation industry to take over one year to collect the accounts receivable in full.

The Company does not charge interest for late payments by its customers. The Company periodically reviews the status of contracts and decides how much of an allowance for doubtful accounts should be made based on factors surrounding the credit risk of customers and historical experience. The Company sets up a doubtful account for a customer based on the aging of the outstanding amount as well as the customer's credit worthiness.

### **Property, plant and equipment, net**

Property, plant and equipment, other than construction in progress, are recorded at cost and are stated net of accumulated depreciation and impairment, if any. Depreciation expense is determined using the straight-line method over the estimated useful lives of the assets as follows:



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Buildings	30 - 50 years
Machinery	5 - 10 years
Software	3 - 5 years
Vehicles	5 - 6 years
Electronic and other equipment	3 - 10 years

Construction in progress represents uncompleted construction work of certain facilities which, upon completion, management intends to hold for production purposes. In addition to costs under construction contracts, other costs directly related to the construction of such facilities, including duty and tariff, equipment installation and shipping costs, and borrowing costs are capitalized. Depreciation commences when the asset is placed in service.

Maintenance and repairs are charged directly to expenses as incurred, whereas betterment and renewals are capitalized in their respective accounts. When an item is retired or otherwise disposed of, the cost and applicable accumulated depreciation are removed and the resulting gain or loss is recognized for the reporting period.

**Prepaid land leases, net**

Prepaid land lease payments, for the land use right of three parcels of land in the PRC, three parcels of leasehold land in Malaysia and one parcel of leasehold land in Singapore, are initially stated at cost and are subsequently amortized on a straight-line basis over the lease terms of 49 to 88 years.

**Acquired intangible assets, net**

Acquired intangible assets are carried at cost less accumulated amortization and any impairment. Intangible assets acquired in a business combination are recognized initially at fair value at the date of acquisition. Intangible assets, except for which are estimated to have an indefinite useful life, are amortized using a straight-line method. Intangible assets estimated to have an indefinite useful life are not amortized but tested for impairment annually or more frequently when indicators of impairment exist.

The estimated useful lives for the acquired intangible assets are as follows:

Category	Estimated useful life
Customer relationship	57 - 60 months
Order backlog	21 - 33 months
Residual values are considered nil.	

### **Goodwill**

Goodwill represents the excess of the purchase price over the estimated fair value of net tangible and identifiable intangible assets acquired. The Company's goodwill outstanding at June 30, 2015 was related to the acquisition of Concord and Bond (see note 3). In accordance with ASC 350, *Intangibles, Goodwill and Other* ("ASC 350"), goodwill is not amortized, but rather is tested for impairment at least annually or more frequently if there are indicators of impairment present.

Goodwill is tested for impairment on June 30 in each year. The Company performs a qualitative assessment to determine if it is more likely than not that the fair value of each identified reporting unit is less than its carrying amount. If this is the case, the Company is not required to calculate the fair value of its reporting unit(s) and perform the two-step impairment test. However, if the Company concludes otherwise, the first step of the two-step impairment test is performed by comparing the carrying value of its reporting unit to its fair value. If the carrying value of the reporting unit is greater than its fair value, the second step is performed, where the implied fair value of goodwill is compared to its carrying value. The Company recognizes an impairment charge for the amount by which the carrying amount of goodwill exceeds its implied fair value.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**(Amounts in thousands except for number of shares and per share data)**

**Impairment of long-lived assets other than goodwill**

The Company evaluates its long-lived assets or asset group including acquired intangibles with finite lives for impairment whenever events or changes in circumstances (such as a significant adverse change to market conditions that will impact the future use of the assets) indicate that the carrying amount of a group of long-lived assets may not be fully recoverable. When these events occur, the Company evaluates the impairment by comparing the carrying amount of the assets to future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets, the Company recognizes an impairment loss based on the excess of the carrying amount of the asset group over its fair value, generally based upon discounted cash flows or quoted market prices.

There was no impairment loss for the periods presented.

**Shipping and handling costs**

All shipping and handling fees charged to customers are included in net revenue. Shipping and handling costs incurred are included in cost of integrated contracts and/or costs of products sold as appropriate.

**Income taxes**

The Company follows the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect in the period in which the differences are expected to reverse. The

Company records a valuation allowance to offset deferred tax assets if based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of the deferred tax assets will not be realized. The effect on deferred taxes of a change in tax rate is recognized in tax expense in the period that includes the enactment date of the change in tax rate.

The Company adopted ASC 740, *Income Taxes* (“ASC 740”), which clarifies the accounting and disclosure for uncertainty in income taxes. Interests and penalties arising from underpayment of income taxes shall be computed in accordance with the related tax laws. The amount of interest expense is computed by applying the applicable statutory rate of interest to the difference between the tax position recognized and the amount previously taken or expected to be taken in a tax return. Interests and penalties recognized in accordance with ASC 740 are classified in the financial statements as a component of income tax expense. In accordance with the provisions of ASC 740, the Company recognizes in its financial statements the impact of a tax position if a tax return position or future tax position is “more likely than not” to prevail based on the facts and technical merits of the position. Tax positions that meet the “more likely than not” recognition threshold are measured at the largest amount of tax benefit that has a greater than fifty percent likelihood of being realized upon settlement. The Company’s estimated liability for unrecognized tax positions which is included in the accrued liabilities is periodically assessed for adequacy and may be affected by changing interpretations of laws, rulings by tax authorities, changes and/or developments with respect to tax audits, and expiration of the statute of limitations. The outcome for a particular audit cannot be determined with certainty prior to the conclusion of the audit and, in some cases, appeal or litigation process. The actual benefits ultimately realized may differ from the Company’s estimates. As each audit is concluded, adjustments, if any, are recorded in the Company’s financial statements. Additionally, in future periods, changes in facts, circumstances, and new information may require the Company to adjust the recognition and measurement estimates with regard to individual tax positions. Changes in recognition and measurement estimates are recognized in the period in which the changes occur.

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**Research and development costs**

Research and development costs consist primarily of salaries, bonuses and benefits for research and development personnel. Research and development costs also include travel expenses of research and development personnel as well as depreciation of hardware equipment and software tools and other materials used in research and development activities. Research and development costs are expensed as incurred. Software development costs are also expensed as incurred as the costs qualifying for capitalization have been insignificant.

**VAT refunds and government subsidies**

Pursuant to the laws and regulations of the PRC, the Company remits 17% of its sales as valued added tax (“VAT”), and then is entitled to a refund of the portion that the Company’s actual VAT burden exceeding 3% levied on all sales containing internally developed software products. VAT refunds are recognized in the statements of comprehensive income when cash refunds or the necessary approval from the tax authority has been received. Certain subsidiaries of the Company located in the PRC receive government subsidies from local PRC government agencies. Government subsidies are recognized in the statement of comprehensive income when the attached conditions have been met. Government grants received for the years ended June 30, 2013, 2014 and 2015 amounted to \$11,322, \$5,792 and \$7,593 respectively, of which \$4,878, \$5,103 and \$2,191 were included as a credit to operating expenses in the statements of comprehensive income for the years ended June 30, 2013, 2014 and 2015, respectively.

**Appropriations to statutory reserve**

Under the corporate law and relevant regulations in the PRC, all of the subsidiaries of the Company located in the PRC are required to appropriate a portion of its retained earnings to statutory reserve. All subsidiaries located in the PRC are required to appropriate 10% of its annual after-tax income each year to the statutory reserve until the

statutory reserve balance reaches 50% of the registered capital. In general, the statutory reserve shall not be used for dividend distribution purposes.

### **Segment reporting**

In accordance with ASC 280, *Segment reporting* (“ASC 280”), segment reporting is determined based on how the Company’s chief operating decision makers review operating results to make decisions about allocating resources and assessing performance of the Company. According to management’s approach, the Company organizes its internal financial reporting structure based on its main product and service offerings. The Company operates in three principal business segments in the financial reporting structure and their management report, namely industrial automation, rail transportation and mechanical and electrical solutions. The Company does not allocate any assets to the three segments as management does not use the information to measure the performance of the reportable segments.

### **Comprehensive income**

Comprehensive income is defined as the changes in equity of the Company during a period from transactions and other events and circumstances excluding transactions resulting from investments by owners and distributions to owners. In accordance with ASC 220, *Comprehensive Income* (“ASC 220”), the Company presents components of net income and other comprehensive income in one continuous statement.

### **Investments in cost and equity investees**

The Company accounts for its equity investments under either the cost method or the equity method by considering the Company’s rights and ability to exercise significant influence over the investees. Under the cost method, investments are initially carried at cost. In the event that the fair value of the investment falls below the initial cost and the decline is considered as other-than-temporary, the Company recognizes an impairment charge, equal to the difference between the cost basis and the fair value of the investment. A variety of factors are considered when determining if a decline in fair value below carrying value is other than temporary, including, among others, the financial condition and prospects of the investee.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

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The investments in entities over which the Company has the ability to exercise significant influence are accounted for using the equity method. Significant influence is generally considered to exist when the Company has an ownership interest in the voting stock of the investee between 20% and 50%. Other factors, such as representation on the investee's board of directors and the impact of commercial arrangements, are also considered in determining whether the equity method of accounting is appropriate.

Under the equity method, original investments are recorded at cost and adjusted by the Company's share of undistributed earnings or losses of these entities, by the amortization of any basis difference between the amount of the Company's investment and its share of the net assets of the investee, and by dividend distributions or subsequent investments. Unrealized inter-company profits and losses related to equity investees are eliminated. An impairment charge, being the difference between the carrying amount and the fair value of the equity investee, is recognized in the consolidated statements of comprehensive income when the decline in value is considered other than temporary.

The impairment loss on investment in cost investees for the years ended June 30, 2013, 2014 and 2015 were nil, \$325 and nil respectively. There was no impairment loss on investments in equity investees for the years ended June 30, 2013, 2014 and 2015, respectively.

**Capitalization of interest**

Interest incurred on borrowings for the Company's construction of facilities and assembly line projects during the active construction period are capitalized. The capitalization of interest ceases once a project is substantially complete. The amount to be capitalized is determined by applying the weighted-average interest rate of the Company's outstanding borrowings to the average amount of accumulated capital expenditures for assets under construction during the year and is added to the cost of the underlying assets and amortized over their respective useful lives.

## **Income per share**

Income per share is computed in accordance with ASC 260, *Earnings Per Share* (“ASC 260”). Basic income per ordinary share is computed by dividing income attributable to holders of ordinary shares by the weighted average number of ordinary shares outstanding during the period. Diluted income per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares.

## **Share-based compensation**

The Company accounts for share-based compensation in accordance with ASC 718, *Compensation-Stock Compensation* (“ASC 718”). The Company recognizes compensation cost for an award with only service conditions that has a graded vesting schedule on a straight-line basis over the requisite service period for the entire award. The compensation cost for each vesting tranche in an award subject to performance vesting is recognized ratably from the service inception date to the vesting date for each tranche. To the extent the required service and performance conditions are not met resulting in the forfeiture of the share-based awards, previously recognized compensation expense relating to those awards are reversed. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in a subsequent period if actual forfeitures differ from initial estimates.

## **Fair value measurements**

The Company has adopted ASC 820, *Fair Value Measurements and Disclosures* (“ASC 820”), which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. It does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. It establishes a three-level valuation hierarchy of valuation techniques based on observable and unobservable inputs, which may be used to measure fair value and include the following:



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- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Classification within the hierarchy is determined based on the lowest level of input that is significant to the fair value measurement.

ASC 820 describes three main approaches to measuring the fair value of assets and liabilities: (1) market approach; (2) income approach and (3) cost approach. The market approach uses prices and other relevant information generated from market transactions involving identical or comparable assets or liabilities. The income approach uses valuation techniques to convert future amounts to a single present value amount. The measurement is based on the value indicated by current market expectations about those future amounts. The cost approach is based on the amount that would currently be required to replace an asset.

**Leases**

Leases have been classified as either capital or operating leases. Leases that transfer substantially all the benefits and risks incidental to the ownership of assets are accounted for as if there was an acquisition of an asset and incurrence of an obligation at the inception of the lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred.

**Accounting for lessor**

Minimum contractual rental from leases are recognized on a straight-line basis over the non-cancelable term of the lease. With respect to a particular lease, actual amounts billed in accordance with the lease during any given period may be higher or lower than the amount of rental revenue recognized for the period. Straight-line rental revenue commences when the customer assumes control of the leased premises. Accrued straight-line rents receivable represents the amount by which straight-line rental revenue exceeds rents currently billed in accordance with lease agreements. Contingent rental revenue is accrued when the contingency is removed.

## **Concentration of risks**

### *Concentration of credit risk*

Assets that potentially subject the Company to significant concentration of credit risk primarily consist of cash and cash equivalents, time deposits with original maturities over three months, restricted cash, accounts receivable, other receivables and amounts due from related parties. The maximum exposure of such assets to credit risk is their carrying amounts as of the balance sheet date. As of June 30, 2015, substantially all of the Company's cash and cash equivalents and time deposits with original maturities exceeding three months were managed by financial institutions located in the PRC, Singapore, Malaysia and Dubai, which management believes are of high credit quality. Accounts receivable, other receivables and amounts due from related parties are typically unsecured and the risk with respect to accounts receivable is mitigated by credit evaluations the Company performs on its customers and its ongoing monitoring process of outstanding balances.

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The Company has no customer that individually comprised 10% or more of the outstanding balance of accounts receivable as of June 30, 2014 and 2015, respectively.

*Concentration of business and economic risk*

A majority of the Company's net revenue and net income are derived in the PRC. The Company's operations may be adversely affected by significant political, economic and social uncertainties in the PRC. Although the PRC government has been pursuing economic reform policies for more than 20 years, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered, especially in the event of a change in leadership, social or political disruption or unforeseen circumstances affecting the PRC's political, economic and social conditions. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective.

*Concentration of currency convertibility risk*

A majority of the Company's businesses are transacted in RMB, which is not freely convertible into foreign currencies. All foreign exchange transactions take place either through the People's Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other regulatory institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

*Concentration of foreign currency exchange rate risk*

The Company's exposure to foreign currency exchange rate risk primarily relates to monetary assets or liabilities held in foreign currencies. Since July 21, 2005, the RMB has been permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. On June 19, 2010, the People's Bank of China announced the end of the RMB's de facto peg to USD, a policy which was instituted in late 2008 in the face of the global financial crisis, to further reform the RMB exchange rate regime and to enhance the RMB's exchange rate flexibility. The exchange rate floating bands will remain the same as previously announced in the inter-bank foreign exchange market. The depreciation of the US dollars against RMB was approximately 2.31%, 0.42% and 0.64% for the years ended June 30, 2013, 2014 and 2015, respectively. Any significant revaluation of RMB may materially and adversely affect the Company's cash flows, revenues, earnings and financial position, and the value of its shares in US dollars. An appreciation of RMB against the US dollar would result in foreign currency translation losses when translating the net assets of the Company from RMB into US dollar.

For the years ended June 30, 2013, 2014 and 2015, the net foreign currency translation gains resulting from the translation of RMB and SGD functional currencies to the U.S. dollar reporting currency recorded in other comprehensive income was \$4,193, \$2,146 and \$1,256, respectively.

### **Recent accounting pronouncements**

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (1) Identify the contract(s) with a customer; (2) Identify the performance obligations in the contract; (3) Determine the transaction price; (4) Allocate the transaction price to the performance obligations in the contract; (5) Recognize revenue when (or as) the entity satisfies a performance obligation. In August 2015, FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date* ("ASU 2015-14"), this update defers the effective date of ASU 2014-09 for all entities by one year. For a public entity, ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017 including interim periods within that reporting period. Early adoption is not permitted. The Company is currently evaluating the impact of the adoption of this standard.

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In January 2015, FASB issued ASU No. 2015-01, *Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items* (“ASU 2015-01”), this update eliminates from GAAP the concept of extraordinary items. *Subtopic 225-20, Income Statement—Extraordinary and Unusual Items*, required that an entity separately classify, present, and disclose extraordinary events and transactions. The amendments in ASU 2015-01 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company will adopt ASU No. 2015-01 on July 1, 2016, and does not expect the adoption of this update to have a material effect on the consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis* (“ASU 2015-02”). ASU No. 2015-02 focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. ASU No. 2015-02 simplifies consolidation accounting by reducing the number of consolidation models from four to two. In addition, the new standard simplifies the FASB Accounting Standards Codification and improves current guidance by: (i) placing more emphasis on risk of loss when determining a controlling financial interest; (ii) reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a Variable Interest Entities (“VIE”); (iii) changing consolidation conclusion for public and private companies in several industries that typically make use of limited partnerships or VIEs. ASU No. 2015-02 will be effective for periods beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. The Company will adopt ASU No. 2015-02 on July 1, 2016, and does not expect the adoption of this update to have a material effect on the consolidated financial statements.

In April 2015, FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs* (“ASU 2015-03”). The amendments in this update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this update. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the

prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (that is, debt issuance cost asset and the debt liability). For public business entities, the amendments in ASU No. 2015-03 are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments in ASU 2015-03 is permitted for financial statements that have not been previously issued. The Company has early adopted ASU 2015-03 on a retrospective basis. There were no prior-period adjustments made to the consolidated financial statements for the years ended June 30, 2013 and 2014 as there were no debt issuance costs incurred. In addition, the impact on current fiscal year's consolidated financial statements was immaterial.

In July 2015, FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory ("ASU 2015-11") The amendments in ASU 2015-11 do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. An entity should measure inventory within the scope of ASU 2015-11 at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. For public business entities, the amendments in ASU 2015-11 are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company will adopt ASU 2015-11 on July 1, 2016, and does not expect the adoption of this update to have a material effect on the consolidated financial statements.

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**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

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**NOTE 3 -BUSINESS COMBINATIONS**

**Acquisition of Bond**

On April 1, 2013, the Company acquired 100% equity interest of the Bond Group, a Singapore headquartered mechanical and electrical solutions service contractor of residential, commercial or industrial building construction and renovation projects in Malaysia and Singapore. The nominal purchase price was \$73,000 combined of cash and ordinary shares, with a total fair value of approximately \$73,805 as of the acquisition date, which consisted of:

- 1) Cash consideration of \$36,500, of which \$16,390 was paid in April 2013, \$5,510 was paid in September 2013, and \$14,600 was paid in September 2014; the cash consideration installments due in September 2013 and September 2014 had present values of \$5,383 and \$13,286, respectively as of the acquisition date.
- 2) Share consideration consisting of 1,407,907 ordinary shares with a market value of \$16,909 on April 1, 2013 were issued and transferred by the Company on May 30, 2013;

Incentive shares issuable to the selling shareholders (“Incentive Shares for Bond”) in two equal installments with acquisition-date fair values of \$10,941 and \$10,896, respectively. Issuance of Incentive Shares for Bond is subject to Bond achieving pre-determined net income performance targets. The Incentive Shares for Bond, if earned, are to be issued within 30 days after the filing of the Company’s annual report on Form 20-F for the fiscal years 2014 and 2015, respectively. The net income performance targets for the Incentive Shares for Bond are as follows:

	<b>First installment</b>	<b>Second installment</b>
Basis of performance target	Net income for the year ending December 31, 2013	Net income for the year ending December 31, 2014
Target net income	\$8,806	\$10,567

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Nominal value of shares	\$10,950	\$10,950
Referencing share price to achieve the nominal value of shares	Average closing price of the Company's shares during the trading days from October 1 to December 31, 2013	Average closing price of the Company's shares during the trading days from October 1 to December 31, 2014

4) Premium shares issuable to the selling shareholders ("Premium Shares for Bond") are capped at 15% of the total Incentive Shares for Bond, or \$3,300, which are subject to Bond achieving a pre-determined compound annual growth rate ("CAGR") performance target of more than 20% for the two-year period from January 1, 2013 to December 31, 2014. The Premium Shares for Bond, if earned, are to be delivered within 30 days after the filing of the Company's annual report on Form 20-F for the fiscal year 2015. The CAGR performance targets for the Premium Shares for Bond for the two-year period are as follows:

<b>CAGR performance target</b>	<b>Premium shares issuable</b>
21%	3% of Incentive Shares for Bond
22%	6% of Incentive Shares for Bond
23%	9% of Incentive Shares for Bond
24%	12% of Incentive Shares for Bond
25% and above	15% of Incentive Shares for Bond



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

As the Incentive Shares for Bond and Premium Shares for Bond are not subject to any service condition of the selling shareholders, they were determined to be within the scope of ASC 820 (note 16). In accordance with ASC 815, “*Derivatives and Hedging*” (“ASC 815”), the Incentive and Premium Shares for Bond are not considered fixed-for-fixed and therefore, are classified as liabilities as of June 30, 2014 and 2015, respectively. Until the contingency is resolved, the change in fair value of the Incentive Shares for Bond and Premium Shares for Bond are recognized in earnings. As of acquisition date, the fair value of the contingent consideration ranges from \$21,837 to \$25,112, depending on whether the 20% - 25% CAGR performance targets disclosed above are achievable.

The acquisition date fair value of the considerations as of the acquisition date is summarized in the below table:

Considerations	<b>Fair value as at April 1, 2013</b>
1) Cash consideration (i)	\$ 35,059
2) Ordinary shares	16,909
3) Incentive Shares for Bond (ii)	21,837
4) Premium Shares for Bond (iii)	-
Total consideration	\$ 73,805

(i) The cash installments of \$16,390, \$5,510 and \$14,600 were paid in May 2013, September 2013 and September 2014, respectively. There was no cash consideration outstanding as of June 30, 2015.

(ii) The first and second installments of the Incentive Shares for Bond had fair values of \$15,887 and \$10,791 respectively as of June 30, 2014, which was recorded as current portion of acquisition-related consideration liabilities,

and non-current portion of the acquisition-related consideration liabilities, respectively as of June 30, 2014. Bond achieved the performance target of the first installment of the Incentive Shares and a total number of 648,697 shares were issuable as of June 30, 2014. Those shares were issued in October 2014. The performance target for the second installment was also achieved, and a total number of 461,107 shares were issuable as of June 30, 2015. The fair value of these shares was \$11,080 as of June 30, 2015 and was recorded in the current portion of acquisition-related consideration liabilities.

(iii) The probability of achieving the growth rate performance target set for Premium Shares for Bond was assessed to be not more than likely as of June 30, 2013. Based on the reassessment of Bond's performance as of June 30, 2014, the probability of achieving the growth rate performance target of 25% CAGR was assessed to be more than likely. The correspondent premium shares for Bond's achieving 25% CAGR is 15% of Incentive Shares for Bond, or 163,401 shares. The fair value of the premium incentive shares was \$4,001 at June 30, 2014, and was recorded as non-current portion of acquisition-related consideration liabilities. The change in assessment of growth rate performance in 2014 resulted in higher fair value of Premium Shares for Bond to be paid to the selling shareholders, which caused a reduction of net income, basic earnings per share, and diluted earnings per share by \$4,002, \$0.07 and \$0.07, respectively. The performance target of 25% and above CAGR growth for premium shares was achieved, hence a total number of 166,471 shares were issuable as of June 30, 2015. The fair value of these shares was \$4,001 as of June 30, 2015 and was recorded as current portion of acquisition-related consideration liabilities.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as of the date of acquisition:

	<b>April 1, 2013</b>
Cash and cash equivalents	\$ 4,460
Time deposits with original maturities over three months	7,486
Restricted cash	242
Accounts receivable	9,966
Cost and estimated earnings in excess of billings	6,340
Other receivables	883
Advances to suppliers	110
Inventories	133
Deferred tax assets	105
Assets held for sale	2,951
Property, plant and equipment	4,891
Prepaid land leases	5,884
Intangible assets	14,359
Investments in equity investees	261
<b>Total identifiable assets acquired</b>	<b>58,074</b>
Short-term bank loans	5,532
Accounts payable	8,655
Deferred revenue	2,315
Income tax payable	1,015
Other tax payable	142
Accrued liabilities	314
Deferred tax liabilities	3,791
Long-term bank loans	2,257
<b>Total liabilities assumed</b>	<b>24,020</b>
<b>Net identifiable assets acquired</b>	<b>34,054</b>
Goodwill	39,751

**Net assets acquired** **\$ 73,805**

The fair value of accounts receivable acquired was \$9,966. Gross contractual accounts receivable acquired totaled \$10,720 and the Company's best estimate of the contractual cash flows not expected to be collected at acquisition date totaled \$754.

The identified intangible assets include acquired customer relationship of \$2,900, with an estimated useful life of 57 months, and acquired order backlog of \$11,459, with an estimated useful life of 21 to 33 months. Intangible assets were valued using the multi-period excess earnings method.

The goodwill, which is not tax deductible, is primarily attributable to synergies expected to be achieved from the acquisition, and was assigned to the mechanical and electrical solutions segment.

The Company recognized \$548 of acquisition-related cost in general and administrative expenses in the statement of comprehensive income for the year ended June 30, 2013.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

For the year ended June 30, 2013, Bond contributed approximately \$22,795 to the Company's total net revenues, and approximately \$1,791 to the Company's net income.

**NOTE 4 - INVENTORIES**

Components of inventories are as follows:

	June 30,	
	2014	2015
Raw materials	\$8,046	\$12,857
Work in progress	12,187	8,157
Finished goods	14,793	13,692
Low value consumables	27	-
	\$35,053	\$34,706

**NOTE 5 - ACCOUNTS RECEIVABLE**

	June 30	
	2014	2015
Accounts receivable	\$284,576	\$286,797
Allowance for doubtful accounts	(25,691 )	(34,259 )
	\$258,885	\$252,538

The movements in allowance for doubtful accounts are as follows:

	June 30,		
	2013	2014	2015
Balance at the beginning of year	\$ 14,287	\$ 20,103	\$ 25,691
Additions	5,945	7,604	13,907
Written off	(556 )	(2,104 )	(5,499 )
Translation adjustment	427	88	160
Balance at the end of year	\$ 20,103	\$ 25,691	\$ 34,259

**NOTE 6 - COSTS AND ESTIMATED EARNINGS IN EXCESS OF BILLINGS**

	<b>June, 30</b>	
	<b>2014</b>	<b>2015</b>
Contracts costs incurred plus estimated earnings	\$ 890,761	\$ 827,955
Less: Progress billings	(705,234)	(653,768)
Cost and estimated earnings in excess of billings	185,527	174,187
Less: Allowance for doubtful accounts	(5,839 )	(8,850 )
	\$ 179,688	\$ 165,337

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

As of June 30, 2014 and 2015, balances of \$16,442 and \$29,752, respectively, were related to contracts which have been completed but were still within the warranty period, of which \$989 and \$1,895, respectively, was expected to be collected after one year.

The movements in allowance for doubtful accounts are as follows:

	June, 30		
	2013	2014	2015
Balance at the beginning of year	\$1,890	\$2,362	\$5,839
Additions	420	3,471	3,085
Written off	-	-	(122 )
Translation adjustment	52	6	48
Balance at the end of the year	\$2,362	\$5,839	\$8,850

**NOTE 7 -PROPERTY, PLANT AND EQUIPMENT**

A summary of property, plant and equipment is as follows:

	June 30,	
	2014	2015
Buildings	\$76,779	\$72,643
Machinery	6,375	7,594
Software	3,718	6,263
Vehicles	4,122	4,012

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Electronic and other equipment	20,682	25,942
Construction in progress	1,997	1,159
	\$113,673	\$117,613
Less: Accumulated depreciation	(31,328 )	(37,391 )
	\$82,345	\$80,222

Total property, plant and equipment with carrying values of \$3,881 and \$1,161 were pledged to secure short-term bank loans (note 14) as of June 30, 2014 and 2015, respectively.

Buildings and vehicles with a total carrying value of \$35,114 and \$32,077 were pledged to secure long-term bank loans as of June 30, 2014 and 2015, respectively (note 15).

Construction in progress consists of capital expenditures and capitalized interest charges related to the construction of facilities and assembly line projects and, in addition, as of June 30, 2014, the expenditures related to the SAP system purchased.



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

The depreciation expenses for the years ended June 30, 2013, 2014 and 2015 were \$6,224, \$7,051 and \$8,508, respectively.

**Assets leased to others under operating leases**

The Company has entered into an operating lease contract with a third party related to certain buildings owned with the carrying amount as shown below:

	June 30,	
	2014	2015
Buildings leased to others - at original cost	\$10,892	\$10,962
Less: accumulated depreciation	(3,547 )	(3,808 )
Buildings leased to others - net	7,345	7,154

**NOTE 8 -PREPAID LAND LEASES**

A summary of prepaid land leases is as follows:

	June 30,	
	2014	2015
Prepaid land leases	\$13,845	\$13,362
Less: Accumulated amortization	(1,448 )	(1,713 )

\$12,397 \$11,649

The amortization for the years ended June 30, 2013, 2014 and 2015 were \$158, \$245 and \$197, respectively.

Of the total prepaid land leases, \$6,517 and \$5,112 as of June 30, 2014 and 2015, respectively, are pledged to secure the long-term bank loans (note 15).

The annual amortization of prepaid land leases for each of the five succeeding years is as follows:

Year ending June 30,	
2016	\$282
2017	282
2018	282
2019	282
2020	282
	\$1,410

#### **NOTE 9 - ASSETS HELD FOR SALE**

The assets held for sale were \$2,847 and nil as of June 30, 2014 and 2015, respectively. The assets held for sale represented residential apartments located in Malaysia acquired through the acquisition of Bond. During fiscal year 2014, the Company entered into several agreements to dispose eight apartments held for sale amounting to \$400 and expected the rest of the apartments to be sold in a short period of time. However, during fiscal year 2015, it appears that it is not probable to dispose the remaining apartments in the near future; hence the Company has re-classified these apartments to property, plant and equipment as they are no longer qualified as assets held for sale according to ASC 360-10-45-44. The company recorded \$377 as depreciation cost for the apartments mentioned above in fiscal year 2015.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

(Amounts in thousands except for number of shares and per share data)

**NOTE 10 - ACQUIRED INTANGIBLE ASSETS, NET**

	<b>June 30, 2014</b>			<b>2015</b>		
	<b>Gross carrying value</b>	<b>Accumulated amortization</b>	<b>Net carrying value</b>	<b>Gross carrying value</b>	<b>Accumulated amortization</b>	<b>Net carrying value</b>
Customer relationships	\$3,404	(1,071	) 2,333	\$3,155	(1,652	) 1,503
Order backlog	12,797	(8,620	) 4,177	11,862	(11,672	) 190
	\$16,201	(9,691	) 6,510	\$15,017	(13,324	) 1,693

The customer relationships and order backlog were related to Concord and Bond, which were acquired on July 1, 2011 and April 1, 2013, respectively. The amortization for the years ended June 30, 2013, 2014 and 2015 were \$2,848, \$5,413 and \$4,454, respectively. The weighted-average remaining amortization periods for customer relationships, order backlog and total intangible assets are 1.75, 1.00 and 1.66 years as of June 30, 2015.

The annual amortization expense relating to the existing intangible assets for each of five succeeding years is as follows:

Year ending June 30,	
2016	\$849
2017	563
2018	281
2019	-
2020	-
	\$1,693

**NOTE 11 -GOODWILL**

The changes in the carrying amount of goodwill are as follows:

	June 30,	
	2014	2015
Balance at beginning of year	\$65,787	\$66,640
Goodwill impairment charge	-	(1,855 )
Translation adjustments	853	(4,867 )
Balance at the end of year	\$66,640	\$59,918

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

Concord, as a component of the M&E operating segment, is considered to be a reporting unit for goodwill impairment purposes as Concord constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of Concord. During the financial year ended June 30, 2015, among other, the Company compared the financial performance of Concord against its budget and determined that it would be more likely than not that the fair value of Concord was less than its carrying amount. The Company engaged an independent third-party appraiser to perform the first step of the two-step goodwill impairment test and concluded that the carrying amount of Concord exceeded its fair value. Thus the Company with the assistance of the independent third-party appraiser continued to measure the amount of impairment loss and recorded a goodwill impairment charge of \$1,855 under the caption of “Goodwill impairment charge” in the statement of comprehensive income.

The Company also performed a qualitative assessment with respect to Bond, the other reporting unit and determined that it was more likely than not that the fair value of the reporting unit exceeded its carrying amount as of June 30, 2015.

**NOTE 12 - INVESTMENTS IN EQUITY AND COST INVESTEES**

The following long-term investments were accounted for under either the equity method or the cost method as indicated:

<b>June 30, 2015</b>	<b>Interest held</b>	<b>Long-term investment, at cost, less impairment</b>	<b>Share of undistributed profits</b>	<b>Advance to investee company</b>	<b>Total</b>
<b>Equity method</b>					
China Techenergy Co., Ltd.	40.00 %	\$ 9,814	(5,953 )	48	3,909
Beijing Hollysys Electric Motor Co., Ltd.	40.00 %	866	3,722	-	4,588
Beijing IPE Biotechnology Co., Ltd.	23.39 %	1,613	2,185	-	3,798

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Beijing Hollysys Machine Automation Co., Ltd.	30.00	%	491	(491	)	-	-
Southcon Development Sdn Bhd.	30.00	%	238	(21	)	-	217
			\$ 13,022	(558	)	48	12,512

**Cost method**

Shenhua Hollysys Information Technology Co., Ltd.	20.00	%	\$ 2,593	-	-	-	2,593
Heilongjiang Ruixing Technology Co., Ltd.	8.31	%	1,773	-	-	-	1,773
Zhongjijing Investment Consulting Co., Ltd.	5.00	%	-	-	-	-	-
Zhejiang Sanxin Technology Co., Ltd.	6.00	%	98	-	-	-	98
			\$ 4,464	-	-	-	4,464

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

(Amounts in thousands except for number of shares and per share data)

<b>June 30, 2014</b>	<b>Interest held</b>	<b>Long-term investment, at cost, less impairment</b>	<b>Share of undistributed profits</b>	<b>Advance to investee company</b>	<b>Total</b>
<b>Equity method</b>					
China Techenergy Co., Ltd.	40.00 %	\$ 9,752	(2,571 )	48	7,229
Beijing Hollysys Electric Motor Co., Ltd.	40.00 %	861	3,144	-	4,005
Beijing IPE Biotechnology Co., Ltd.	23.39 %	1,603	1,926	-	3,529
New Huake Electronic Technology Co., Ltd.	37.50 %	244	(244 )	-	-
Beijing Hollysys Machine Automation Co., Ltd.	30.00 %	488	(441 )	-	47
Southcon Development SDN BHD	30.00 %	280	(28 )	-	252
		\$ 13,228	1,786	48	15,062
<b>Cost method</b>					
Shenhua Hollysys Information Technology Co., Ltd.	20.00 %	\$ 2,577	-	-	2,577
Heilongjiang Ruixing Technology Co., Ltd.	8.31 %	1,761	-	-	1,761
Zhongjijing Investment Consulting Co., Ltd.	5.00 %	-	-	-	-
Zhejiang Sanxin Technology Co., Ltd.	6.00 %	98	-	-	98
		\$ 4,436	-	-	4,436

In April 2013, the Company acquired a 30% equity interest of Southcon Development Sdn. Bhd., as a result of the acquisition of Bond.

For the year ended June 30, 2013, the Company recorded dividend income of \$834 from Heilongjiang Ruixing Technology Co., Ltd., an investee which is accounted for by the Company under the cost method, out of which \$196 was received during the year ended June 30, 2014.

In December 2013, the Company made additional cash injection of RMB 24,000 (equivalent to \$3,901) into China Techenergy Co., Ltd. (“China Techenergy”) which increased the investment cost in China Techenergy to RMB 60,000 (equivalent to \$9,752). The other investor has also made additional cash injection that corresponds with their portion

of the investment in China Techenergy, therefore the Company's percentage of interest in China Techenergy remains the same at 40% and the Company continues to use equity method to account for the investment.

For the year ended June 30, 2014, the Company received a dividend of \$2,408 from China Techenergy Co., Ltd.

For the year ended June 30, 2014, the Company recognized an impairment loss of RMB2,000 (equivalent to \$325) against the investment in Zhongjijing Investment Consulting Co., Ltd ("Zhongjijing"). As a result, the balance of investment in Zhongjijing was reduced to nil as of June 30, 2014. Zhongjijing has ceased operations and the Company expects that the recoverable amount of the investment in Zhongjijing to be nil.



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

The Company holds a 20% equity interest of Shenhua Hollysys Information Technology Co. Ltd. (“Shenhua Information”), but uses the cost method to account for the investment because:

1) Only one out of the five board representatives is elected by the Company and the remaining 80% equity interest is held by a large state-owned company which, in the view of the management, operates Shenhua Information without regards to the views of the Company;

2) Key management of Shenhua Information including the chief executive officer, chief financial officer, chief operating officer and head of accounting are all appointed by the other shareholder.

3) Based on the articles of association of Shenhua Information, there are no matters that require unanimous approval of all shareholders and there are no participating rights for noncontrolling shareholders.

In November 2014, the Company entered into an agreement to dispose all of its 37.5% interest in New Huake Electronic Technology Co., Ltd., for a gain of RMB490 (equivalent to \$80), and the gain was recognized in the gain on disposal of long term investments in the consolidated statements of comprehensive income for the year ended June 30, 2015.

For the year ended June 30, 2015, the Company received dividend of \$249 from Shenhua Hollysys Information Technology Co. Ltd.

**NOTE 13 - WARRANTY LIABILITIES**

	June 30,	
	2014	2015
Beginning balance	\$3,961	\$7,616
Expense accrued	7,433	6,647
Expense incurred	(3,790)	(3,924 )
Translation adjustment	14	48
	\$7,618	\$10,387
Less: current portion of warranty liabilities	(4,014)	(7,310 )
Long-term warranty liabilities	\$3,604	\$3,077

**NOTE 14 -SHORT-TERM BANK LOANS**

On June 30, 2014, the Company’s short-term bank borrowings consisted of revolving bank loans of \$4,494 from several banks, which were subject to annual interest rates ranging from H.24% to 1.32%, with a weighted average interest rate of 1.11%. The short-term loan are secured by the pledge of guarantee by Beijing Hollysys amounting to \$5,385 with restricted cash and buildings with carrying values of \$1,504 and \$3,881 as of June 30, 2014, respectively.

On June 30, 2015, the Company’s short-term bank borrowings consisted of revolving bank loans of \$16,295 from several banks, which were subject to annual interest rates ranging from 1.5% to 5.12%, with a weighted average interest rate of 1.78%. The short-term loan are secured by the pledge of guarantee by Beijing Hollysys amounting to \$19,202 with restricted cash and buildings with carrying values of \$18,041 and \$1,161 as of June 30, 2015, respectively.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

For the years ended June 30, 2013, 2014, and 2015, interest expenses on short-term bank loans amounted to \$392, \$5 and \$286 respectively.

As of June 30, 2014, the Company had available lines of credit from various banks in the PRC and Malaysia amounting to \$173,670, of which \$34,337 was utilized and \$139,332 is available for use. These lines of credit were secured by the pledge restricted cash and buildings with the carrying value of \$7,941.

As of June 30, 2015, the Company had available lines of credit from various banks in the PRC and Malaysia amounting to \$230,074, of which \$68,435 was utilized and \$161,639 is available for use. These lines of credit were secured by the pledge restricted cash and buildings with the carrying value of \$7,991.

**NOTE 15 - LONG-TERM LOANS**

		June 30,	
		2014	2015
RMB-denominated loan	(i)	17,065	8,996
USD-denominated loan	(ii)	4,663	4,794
MYR-denominated loan	(iii)	1,713	936
SGD denominated loan	(iv)	54	364
Convertible Bond	(v)	\$-	\$19,572
		23,495	34,662
Less: current portion		(8,517)	(14,111)
		\$ 14,978	\$ 20,551

i. The RMB denominated loan is repayable in three installments with the last installment due on March 29, 2016. It carries an annual interest rate of 5.94% subject to yearly adjustments by reference to the benchmark rate over the same period announced by the People's Bank of China with nil premiums. The loan is secured by a pledge of the

headquarters facility in Beijing, comprising a prepaid land lease and buildings with an aggregate carrying value of \$37,986 and \$35,091 as of June 30, 2014 and 2015, respectively.

ii. The two USD denominated loans are both repayable in one installment by July 31, 2016 and September 29, 2019 respectively. For the fiscal year ended June 30, 2015, the effective interest rates ranged from 2.1% to 3.03%. The borrowings are secured by restricted cash amounting to \$5,103 and \$5,136 as of June 30, 2014 and 2015, respectively.

iii. The MYR denominated loans are repayable in two to forty six installments with the last installment due on March 25, 2019. For the year ended June 30, 2015, the effective interest rates ranged from 2.30% to 6.85% per annum. The borrowings are secured by the mortgages of buildings, vehicles, and prepaid land leases in Malaysia, with an aggregate carrying value of \$3,465 and \$1,258 as of June 30, 2014 and 2015, respectively.

iv. The SGD denominated loans are repayable in ten to sixty four installments with the last installment due on March 13, 2023. For the year ended June 30, 2015, the effective interest rates ranged from 2.28% to 7.15% per annum. The borrowing is secured by vehicles and restricted cash with a total carrying value of \$181 and \$840 as of June 30, 2014 and 2015 respectively.

#### v. Convertible Bond

On May 30, 2014, the Company entered into a Convertible Bond agreement with International Finance Corporation ("IFC"), under which the Company borrowed \$20,000 from IFC (the "Convertible Bond") with an interest rate of 2.1% per annum and commitment fee of 0.5% per annum paid in arrears semi-annually. The Convertible Bond has a five year term and was drawn down on August 30, 2014 and is repayable in full on August 29, 2019. The loan may not be prepaid before it is due.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Conversion rate

The initial conversion rate at the time of the agreement is 38 ordinary shares per \$1, and the initial conversion price is \$26.35 per share. The initial conversion rate and conversion price are subject to subsequent adjustments with events that may dilute the unit price per share. Since the Company paid out a cash dividend for \$0.4 per share in March 2015, the conversion rate has been adjusted to 38.84 ordinary shares per \$1 with the conversion price of \$25.75 per share.

Conversion

The Convertible Bond has both voluntary and mandatory conversion terms. IFC may at its option convert, in \$1,000 increments, the Convertible Bond in whole or in part, into the Company's ordinary shares at any time on or prior to the maturity date at a conversion rate and a conversion price in effect at such time. The conversion rate is subject to anti-dilution. According to the convertible bond agreement, 50% of the principal amount of the Convertible Bond then outstanding will be mandatorily converted into ordinary shares of the Company at the conversion rate and conversion price then in effect if at any time, with respect to the period of 30 consecutive trading days ending at such time, the volume weighted average prices for 20 trading days or more in such 30 consecutive trading day period is equal to or more than 150% of the conversion price in effect at such time. In addition, 100% of the principal amount of the Convertible Bond then outstanding will be mandatorily converted into ordinary shares at the conversion rate and conversion price then in effect if at any time, with respect to the period of 30 consecutive trading days ending at such time, the volume weighted average prices for 20 trading days or more in such 30 consecutive trading day period is equal to or more than 200% of the conversion price in effect at such time.

Default Rate Interest

In the event that payments for interest or principal are late, the default interest is payable at 2% from the date on which the payment of the relevant overdue amount became due until the date of actual payment.

Non-conversion compensation feature

In the event that there remains any outstanding principal of the Convertible Bond not converted by IFC into ordinary shares at the maturity date, the Company shall pay to IFC an additional amount equal to 4% of such outstanding principle (“non-conversion compensation feature”).

Registration rights agreement

The Company is required to file a shelf-registration statement with the United States Securities and Exchange Commission covering the resale of any ordinary shares issued or issuable upon conversion of the Convertible Loan. The Company shall maintain the effectiveness of the registration statement for so long as any registrable securities remain issued and outstanding. In the event that the registration statement is not declared effective or ceases to remain continuously effective such that IFC is not able to utilize the prospectus to resell its ordinary shares, the Company shall pay a penalty equal to 0.5% of the aggregate principal amount of the Convertible Bond that was converted into unregistered ordinary shares then held by IFC. The maximum aggregate penalty payable to IFC shall be 5% of the aggregate principal amount of the Convertible Bond that was converted.

In accounting for the issuance of the Convertible Bond, the Company bifurcated the non-conversion compensation feature from the Convertible Bond in accordance with ASC 815-15-30-2. The bifurcated feature is accounted for as a liability at its fair value in each reporting period. The Company did not bifurcate the conversion option, as it is considered indexed to the entity’s own stock and meets the equity classification guidance in ASC 815-40-25, it is eligible for a scope exception from ASC 815 and does not need to be bifurcated from the underlying debt host instrument. At the commitment date, there was no beneficial conversion as the conversion price was higher than the stock price. The fees and expenses associated with the issuance of the Convertible Bond are recorded as a discount to the debt liability in accordance with ASU 2015-03, which the Company has early adopted in fiscal year ended June 30, 2015. The Convertible Bond, which is the proceeds net of fees and expenses payable to the creditor and the fair value of the bifurcated derivative, will be accreted to the redemption value on the maturity date using the effective interest method over the estimated life of the debt instrument. The registration right liability is accounted for in accordance with ASC 450-20 which defines that a liability should be recorded in connection with the registration rights agreement when it becomes probable that a payment under the registration rights agreement would be required and the amount of payment can be reasonably estimated. As of June 30, 2015, the Company did not recognize any liability related to the registration right.

The Company paid up-front fees related to the issuance of the Convertible Bond amounting to \$349.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

For fiscal year 2015, the accretion of the Convertible Bond discount was \$192.

Scheduled principal payments for all outstanding long-term loans as of June 30, 2015 are as follows:

Year ending June 30,	
2016	\$14,111
2017	446
2018	376
2019	19,670
2020 and onwards	59
	\$34,662

For the years ended June 30, 2013, 2014, and 2015, interest expenses incurred amounted to \$2,197, \$2,792 and \$1,536, of which \$1,778, \$1,998 and \$1,536 was recorded as interest expenses, and \$419, \$793 and nil was capitalized as construction in progress, respectively.

**NOTE 16 - FAIR VALUE MEASUREMENT**

Financial instruments include cash and cash equivalents, time deposits with maturities over three months, accounts receivable, other receivables, amounts due to or from related parties, accounts payable, short-term bank loans, long-term bank loans and bifurcated derivative. The carrying values of these financial instruments, other than long-term bank loans and bifurcated derivatives (which is a recurring fair value measurement) approximate their fair values due to their short-term maturities. The carrying value of the Company's long-term bank loans other than the Convertible Bond approximates its fair value as the long-term bank loans are subject to floating interest rates. These assets and liabilities, excluding cash and cash equivalents (which fall into level 1 of the fair value hierarchy), fall into level 2 of the fair value hierarchy. The carrying value of the Convertible Bond as of June 30, 2015 is \$19,572, whereas the fair value is \$21,452. The fair value measurement of Convertible Bond falls into level 3 of the fair value hierarchy.

For the year ended June 30, 2014, the Company recognized an impairment loss of RMB 2,000 (equivalent to \$325) against the investment in Zhongjijing. As a result, the balance of the investment in Zhongjijing was reduced to nil as of June 30, 2014. Zhongjijing has ceased its operations and the Company expects that the recoverable amount of the investment in Zhongjijing to be nil.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2014, and 2015 are stated below:

	June 30, 2014			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
<b>Liabilities:</b>				
Acquisition-related consideration <sup>(ii)</sup>	\$-	\$ -	\$ 30,680	\$30,680



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

(Amounts in thousands except for number of shares and per share data)

	June 30, 2015 Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Liabilities:				
Non-conversion compensation feature related to the Convertible Bond <sup>(i)</sup>	\$-	\$ -	\$ 305	\$305
Acquisition-related consideration <sup>(ii)</sup>	15,081	-	-	15,081
Total liabilities measured at fair value on a recurring basis	\$15,081	\$ -	\$ 305	\$15,386

The non-conversion compensation feature represents the fair value of the non-conversion compensation feature (note 15). The Company engaged an independent third-party appraiser to assist with the valuation of the feature. The Company is ultimately responsible for the fair value of the non-conversion compensation feature recorded in the consolidated financial statements. The Company adopted the binomial model to assess the fair value of such feature as of year-end. The non-conversion compensation feature is equal to the difference between the fair value of (i) the fair value of the whole Convertible Bond with non-conversion compensation feature but without any mandatory conversion option and the whole Convertible Bond without any mandatory conversion option and the non-conversion feature. The significant unobservable inputs used in the fair value measurement of the non-conversion compensation feature includes the risk-free rate of return, expected volatility, expected life of the Convertible Bond and expected ordinary dividend yield. The changes in fair value of the non-conversion compensation feature during fiscal year 2015 are shown in the following table.

**Fair value measurements as of  
June 30, 2015 using significant**

**unobservable inputs  
(Level 3)**  
Non-conversion compensation  
feature related to the Convertible  
Bond

Balance as of August 30, 2014	\$	270
Change in fair-value (included within other expenses, net)		35
Balance as of June 30, 2015	\$	305

Acquisition-related consideration represents the fair value of Incentive Shares and Premium Shares for Bond (note 3). The fair value of the contingent consideration in connection with the acquisition was estimated using probability-weighted discounted cash flow models. Key assumptions include discount rate, a percent weighted-probability of Bond achieving net income performance targets and a percent weighted-probability of Bond achieving CAGR performance targets. For the fair value measurement as of June 30, 2014, the referencing share price to determine the amount of Incentive and Premium Shares issuable is based on the average future share price from October 1 to December 31, 2014. This was estimated using a Monte Carlo model simulation. As of June (i) 30, 2015, Bond has achieved the net income performance target and the CAGR performance target. In addition, the referencing share price was determinable as of December 31, 2014 and the remaining input to the fair value of the Incentive and Premium Shares for Bond is the Company's share price on the date of issuance, which is observable from an active market. Therefore, the fair value measurement of the acquisition-related consideration is transferred from Level 3 to Level 1 on December 31, 2014. As of June 30, 2014 and June 30, 2015, the fair value of the acquisition-related consideration in connection with Bond totaled \$30,680 and \$15,081, respectively. The changes in fair value of acquisition-related consideration in connection with the Bond acquisition is shown in the following table:

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

(Amounts in thousands except for number of shares and per share data)

**Fair value measurements as of June 30, 2015**

**using significant unobservable inputs  
(Level 3)**

Contingent consideration in connection with Bond acquisition

Balance as at June 30, 2013	\$	22,691	
Change in fair-value (included within other expenses, net)		7,989	
Balance as at June 30, 2014	\$	30,680	
Issuance and settlement		(15,231	)
Change in fair-value (included within other expenses, net)		(101	)
Balance as at December 31, 2014		(15,332	)
Transfer out		15,332	
Balance as at June 30, 2015	\$	-	

Assets measured at fair value on a nonrecurring basis as of June 30, 2015 are stated below:

<b>June 30, 2015</b>			
<b>Quoted prices in active markets for identical assets (Level 1)</b>			
<b>Significant other observable inputs</b>	<b>Significant unobservable inputs</b>		
<b>(Level 2)</b>	<b>(Level 3)</b>		<b>Total</b>

**Assets:**

Goodwill <sup>(i)</sup>	\$-	\$	-	\$ 23,285	\$23,285
<b>Total assets measured at fair value on a non-recurring basis</b>	\$-	\$	-	\$ 23,285	\$23,285

(i) The Company's goodwill of \$23,285 is related to the acquisition of Concord and \$36,633 is related to the acquisition of Bond (note 3). The Company engaged an independent third-party appraiser to assist with the valuation of the goodwill related to the Concord acquisition. The Company is ultimately responsible for the fair value of the goodwill related to Concord acquisition recorded in the consolidated financial statements. For the purposes of step one of the goodwill impairment test, the Company has adopted the income approach, in particular the discounted cash flow approach, to evaluate the fair value of the reporting unit. In applying the discounted cash flow approach, key assumptions include timing of future expected cash flows, terminal value growth rates and appropriate discount rates. For the purpose of step two of the goodwill impairment test, the Company has allocated the fair value of the reporting unit derived in step one to the assets and liabilities of the reporting unit, as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The Company adopted the multi-period excess earnings model to evaluate the fair value of the intangible assets of the reporting unit, which was then used to compute the implied fair value of the goodwill via a residual approach. As a result, the Company recorded a goodwill impairment charge of \$1,855 (Note 11).

**NOTE 17 - STOCKHOLDERS' EQUITY**

In August 2010, the Board of Directors adopted the 2010 Rights Plan. The 2010 Rights Plan provides for a dividend distribution of one preferred share purchase (the "Right"), for each outstanding ordinary share. Each Right entitles the shareholder to buy one share of the Class A Preferred Stock at an exercise price of \$160. The Right will become exercisable if a person or group announces an acquisition of 20% or more of the outstanding ordinary shares of the Company, or announces commencement of a tender offer for 20% or more of the ordinary shares. In that event, the Right permits shareholders, other than the acquiring person, to purchase the Company's ordinary shares having a market value of twice the exercise price of the Right, in lieu of the Class A Preferred Stock. In addition, in the event of certain business combinations, the Right permits the purchase of the ordinary shares of an acquiring person at a 50% discount. Right held by the acquiring person becomes null and void in each case. Unless terminated earlier by the Board of Directors, the 2010 Rights Plan will expire on September 27, 2020. There is no accounting impact related to the Right.

On May 30, 2013 and October 29, 2014, pursuant to the terms of the acquisition of Bond, the Company issued 1,407,907 and 648,697 ordinary shares, respectively, as partial consideration (note 3).

On February 9, 2015, the Company declared a special cash dividend of US\$0.40 per share to the holders of the Company's ordinary shares. The record date was February 23, 2015, and the dividend was paid on March 16, 2015.

**NOTE 18 - SHARE-BASED COMPENSATION EXPENSES**

On September 20, 2007, the Company adopted the “2006 Stock Plan” (the “2006 Plan”) which allows the Company to offer a variety of incentive awards to employees, officers, directors and consultants. Options to purchase 3,000,000 ordinary shares are authorized under the 2006 Plan. The Company issues new shares to employees, officers, directors and consultants upon share option exercise or share unit conversion.

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

On May 14, 2015, the Board of Directors approved the 2015 Equity Incentive Plan (the “2015 Equity Plan”). The 2015 Equity Plan provided for 5,000,000 ordinary shares, and it will terminate ten years following the date that it was adopted by the Board of Directors. The purposes of the 2015 Equity Plan are similar as the 2006 Plan, which is used to promote the long-term growth and profitability of the Company and its affiliates by stimulating the efforts of employees, directors and consultants of the Company and its affiliates who are selected to be participants, aligning the long-term interests of participants with those of shareholders, heightening the desire of participants to continue in working toward and contributing to the success of the Company, attracting and retaining the best available personnel for positions of substantial responsibility, and generally providing additional incentive for them to promote the success of the Company’s business through the grant of awards of or pertaining to the Company’s ordinary shares. The 2015 Equity Plan permits the grant of incentive share options, non-statutory share options, restricted shares, restricted share units, share appreciation rights, performance units and performance shares as the Company may determine.

Share options

The Company granted 696,000 share options in 2008 and 2009 under the 2006 Plan. All the share options had been vested and exercised by June 30, 2013, and there was no share option activity for the years ended June 30, 2014 and 2015.

The total intrinsic value of share options exercised during the years ended June 30, 2013, 2014 and 2015 was \$663, nil and nil, respectively. No share options were vested during the years ended June 30, 2013, 2014 and 2015. No share options were exercised during the years ended June 30, 2014 and 2015.

The Company recorded share-based compensation expense relating to share options in general and administrative expenses. There was no share-based compensation expense recorded for the years ended June 30, 2013, 2014 and 2015. As of June 30, 2014 and 2015, there was no unrecognized share-based compensation expense to be recognized for the above share options.

Performance options

**Performance share options granted in 2012 (“2012 Performance Options”)**

On February 20, 2012, performance share options to purchase 1,476,000 ordinary shares were granted to certain employees of the Company under the terms of the 2006 Plan. They were granted with an exercise price of \$9.29 per share. These shares options have an expiry period of five years from the date of grant, and would vest subject to the service and performance conditions shown below:

For 60,000 options, if the Company’s Price/Earnings Ratio (“P/E”) achieves certain levels and the related investor relations performance targets are achieved during the 36 months after the grant date, 30,000 share options or 60,000 share options will vest depending on the related manager’s performance; The 60,000 options will cliff vest on the 36 month anniversary of the grant date, and will remain exercisable from the vesting date until the 60 month anniversary of the grant date. For this particular type of options, the Company recorded nil, \$206 and \$72 as share-based compensation expenses in the years ended June 30, 2013, 2014 and 2015, respectively.

For 1,416,000 options, if the compound average growth rate of the Company’s Non-GAAP diluted earnings per share as defined in the 2006 Plan from the year ended June 30, 2011 to the year ended June 30, 2014 (the “EPS Threshold”) equals or exceeds 15%, but less than 20%, 944,000 options will vest; if the EPS Threshold equals or exceeds 20%, but is less than 25%, an additional 236,000 options will vest; if the EPS Threshold equals or exceeds 25%, an additional 236,000 options will vest. Of the total 1,416,000 options, 283,200, 283,200 and 849,600 options will vest on the 24 month, 36 month, and 48 month anniversary of the grant date, respectively. The vesting schedule for such performance share options is as below:

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

EPS Threshold	Number of vested options	Months after the grant date		
		24 months	36 months	48 months
Over 15% but below 20%	944,000	283,200	283,200	377,600
Equal or over 20% but below 25%	Additional 236,000	-	-	236,000
25% or above	Additional 236,000	-	-	236,000
	Total	283,200	283,200	849,600

The options will remain exercisable from the vesting date until the 60 month anniversary of the grant date. The EPS target threshold was met as of June 30, 2014 and all of the 1,416,000 options vested. For this particular type of options, the Company recorded nil, \$1,222 and \$1,530 as share-based compensation expenses in years ended June 30, 2013, 2014 and 2015, respectively.

A summary of the 2012 performance share option activity under the 2006 Plan for the year ended June 30, 2015 is as follows:

<b>2012 performance options</b>	<b>Number of shares</b>	<b>Weighted average exercise price</b>	<b>Weighted average remaining contractual life (years)</b>	<b>Aggregate intrinsic value</b>
Outstanding at June 30, 2014	1,476,000	\$ 9.29	2.64	\$ 22,435
Exercised	(142,500 )	\$ 8.98		
Outstanding at June 30, 2015	1,333,500	\$ 8.89	1.64	\$ 20,189
Vested and expected to vest at June 30, 2015	1,476,000	\$ 8.89	1.64	\$ 22,347
Exercisable at June 30, 2015	483,900	\$ 8.89	1.64	\$ 7,326



The aggregated intrinsic value of the 2012 performance options exercised during the years ended June 30, 2013, 2014 and 2015 was nil, nil and \$2,383, respectively.

The aggregated vested-date fair value of 2012 performance options vested during years ended June 30, 2013, 2014, 2015 is nil, \$5,480 and \$6,497 respectively.

The Company recorded share-based compensation expense relating to 2012 performance share options of \$1,317, \$2,654 and \$1,602 which is included in general and administrative expenses, for the years ended June 30, 2013, 2014 and 2015, respectively. As of June 30, 2015, total unrecognized share-based compensation expense of \$635 related to 2012 performance options is expected to be recognized over a weighted average vesting period of 0.64 years.

The Company paid out a cash dividend of \$0.40 per share in March 2015 and the exercise price was adjusted to \$8.89 according to the term outline in the 2006 Plan and the performance option agreement.

The valuation-date fair value of each 2012 performance share option granted is estimated on the date of grant using the Black-Scholes-Merton Option Pricing Model. The following table presents the assumptions used to estimate the fair values of the share options granted in the periods presented:

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

**For options granted on**

**February 20, 2012**

Risk-free rate of return	0.71	%
Expected life (in years)	4.17	
Weighted average expected volatility	62.64	%
Expected dividends	-	

Weighted average risk-free rate of return for periods within the contractual life of the option is based on the U.S. treasury yield curve in effect at the time of grant. Expected option life is estimated based on historical options exercise pattern in accordance with ASC 718. Expected volatility is estimated based on historical volatility of the Company's stock. Dividend yield is estimated by the Company at zero for the expected option life. The exercise price of the option will be adjusted in the event dividend paid by the Company.

**Performance options granted in 2015 (“2015 Performance Options”)**

On May 14, 2015, certain employees of the Company were granted share-based compensation awards totaling 1,740,000 performance share options to purchase ordinary shares according to the terms of the 2015 Equity Plan. The exercise price of these options is \$22.25 per share. The exercise price of the option will be adjusted in the event dividend paid by the Company.

On the 24, 36, 48 months anniversary of the grant date, 30%, 30%, 40% of 1,160,000 options will vest if the Company's CAGR of Non-GAAP diluted EPS for fiscal years 2015, 2016 and 2017 equals or exceeds 15% per annum. On the 48 month anniversary of the grant date, 50% of the remaining 580,000 options will vest if the Company's CAGR of Non-GAAP diluted EPS for fiscal years 2015 to 2017 equals or exceeds 20%, and another 50% of the 580,000 options will vest if the Company's CAGR of Non-GAAP diluted EPS for fiscal years 2015 to 2017 equals or exceeds 25%.

Moreover, for option grantees who are responsible for individual businesses, they have to meet the following additional criteria in each year, from fiscal years 2015 to 2017, to exercise the options in that particular year. The annual revenue growth rate compared to prior fiscal year must equal to or exceed 15%, 5%, 15% and 50% respectively for industrial automation, rail transportation, mechanical and electrical solutions and medical revenue streams.

The vesting schedule for such performance share options is as below:

EPS Threshold	Revenue growth threshold	Number of vested options	Months after the grant date		
			24 months	36 months	48 months
Over 15% but below 20%	IA, Rail, M&E, Medical over 15%, 5%, 15%, 50% respectively	1,160,000	348,000	348,000	464,000
Equal or over 20% but below 25%		Additional 290,000	-	-	290,000
25% or above		Additional 290,000	-	-	290,000
		<b>Total</b>	<b>348,000</b>	<b>348,000</b>	<b>1,044,000</b>

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

The options will remain exercisable from the vesting date until the 60 month anniversary of the grant date. The EPS threshold and the revenue growth thresholds for rail transportation and medical were met for fiscal year ends June 30, 2015, however, the revenue growth thresholds of industrial automation and mechanical and electrical was not achieved. The Company expects the CAGR of Non-GAAP diluted EPS for fiscal year 2016 and 2017 will fall between 15% and 20 %, in additional, the revenue growth thresholds are expected to be met for all revenue streams. Based on the previous assumption, 1,055,000 out of 1,740,000 2015 performance options are expected to be vested.

A summary of the 2015 performance option activity for the year ended June 30, 2015 is as shown below:

2015 performance options	Number of shares	Weighted average exercise price	Weighted average remaining contractual life (years)	Aggregate intrinsic value
Outstanding at June 30, 2014	-	\$ -	-	\$ -
Granted	1,740,000	22.25		
Outstanding at June 30, 2015	1,740,000	\$ 22.25	4.87	\$ 3,097
Expected to vest at June 30, 2015	1,055,000	\$ 22.25	4.87	\$ 1,878
Exercisable at June 30, 2015	-	\$ -	-	\$ -

The weighted averaged grant-date fair value of the 2015 performance options granted in fiscal year 2015 is \$22.22.

There was no 2015 performance options vested or exercised during fiscal year 2015.

The Company recorded share-based compensation expense relating to the 2015 performance options in the amount of \$471 which is included in general and administrative expenses, in fiscal year 2015. As of June 30, 2015, total

unrecognized share-based compensation expense of \$10,293 related to 2015 performance options is expected to be recognized over a weighted average vesting period of 4.87 years.

For the 2015 performance options, the Company engaged an independent third-party appraiser to assist with the valuation of the option. The Company has adopted the binomial option pricing model to assess the fair value as of the valuation date.

The major inputs to the binomial model are as follows:

	For options granted on May 14, 2015	
Risk-free rate of return	1.51	%
Weighted average expected volatility	53.42	%
Expected life (in years)	5 years	
Expected ordinary dividend yield	nil	

Historically the Company adopted the Black-Scholes-Merton option pricing model to evaluate the fair value of share-based compensation awards. During the year ended June 30, 2015, the Company granted new performance options to its employees (Note 18). The Company engaged an independent third-party appraiser to assist with the derivation of the fair value of the share-based compensation awards. The Company is ultimately responsible for the determination of all amounts related to share-based compensation recorded in the consolidated financial statements. Based on the information available, the Company concluded that the binomial option pricing model, a lattice model, will yield a better estimation of the fair value compared to the Black-Scholes-Merton option pricing model, which is a closed-form model. Hence, the Company changed the option-valuation technique to the binomial option pricing model for new share-based compensation awards granted after July 1, 2014 in accordance with ASC 718-10-55-20.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Restricted shares

During the year ended June 30, 2011, the Company granted 67,500 restricted ordinary shares to certain directors under the 2006 Plan, of which 15,000 shares were granted on January 1, 2011, 22,500 shares were granted on February 1, 2011, and the remaining 30,000 were granted on June 2, 2011. These restricted shares vest quarterly over a three year period starting from the grant date. Fair value of the restricted shares was determined with reference to the market closing price at grant date.

During the year ended June 30, 2014, the Company granted 52,500 restricted ordinary shares to certain directors under the 2006 Plan. All shares were granted on June 23, 2014. These restricted shares vest quarterly over a three year period starting from the directors' respective service inception date. Fair value of the restricted shares was determined with reference to the market closing price at grant date.

A summary of the restricted share activity for the year ended June 30, 2015 is as follows:

	Number of restricted shares	Weighted average grant-date fair value
Un-vested at June 30, 2014	49,375	23.95
Exercised	(12,500)	) 16.07
Vested	(17,500)	) 23.95
Un-vested at June 30, 2015	31,875	23.95

The aggregated grant-date fair value of restricted shares vested during the years ended June 30, 2013, 2014 and 2015 were \$283, \$290 and \$419 respectively. \$283, \$290 and \$419 were recorded in general and administrative expenses as restricted share compensation expenses, for the years ended June 30, 2013, 2014 and 2015, respectively. As of June 30, 2015, the aggregated unrecognized compensation expense of \$694 related to the restricted shares is expected to be recognized over a weighted-average vesting period of 1.66 year.

**NOTE 19 - EMPLOYEE BENEFITS**

The Company contributes to a state pension scheme run by the Chinese government in respect of its employees in China, a central provision fund run by the Singapore government in respect of its employees in Singapore, and an employment provident fund in respect of its employees in Malaysia. The expenses related to these plans were \$15,031, \$16,150 and \$17,018 for the years ended June 30, 2013, 2014 and 2015, respectively. These schemes were accounted for as defined contribution plans.

**NOTE 20 - INCOME TAX**

BVI

Hollysys, and its subsidiaries, GTH and Clear Mind, are incorporated in the BVI and are not subject to income tax under the relevant jurisdiction.

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

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**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Singapore

HI, HAP, CCPL, CEPL, BCPL and BMSG, the Company's wholly owned subsidiaries incorporated in Singapore, are subject to Singapore corporate tax rate of 17% on the assessable profits arising from Singapore.

Malaysia

CESB, BMJB, and BMKL, the Company's wholly owned subsidiaries incorporated in Malaysia, are subject to Malaysia corporate income tax rate of 25% on the assessable profits arising from Malaysia.

Dubai

CCPL Dubai, the branch of the Company's wholly owned subsidiary, CCPL, is a tax exempt company incorporated in Dubai, and no tax provision has been made for the years ended June 30, 2013, 2014 and 2015, respectively.

Hong Kong

World Hope and CSHK, the Company's wholly owned subsidiaries incorporated in Hong Kong, are subject to Hong Kong profits tax at a rate of 16.5% on the assessable profits arising from Hong Kong. No provision for Hong Kong profits tax has been made in the statements of comprehensive income as there were no assessable profits arising from Hong Kong for the years ended June 30, 2013, 2014 and 2015, respectively.



## Macau

CMDE, the Company's wholly owned subsidiary incorporated in Macau, is subject to the Macau corporate income tax rate of 12% on the assessable profits arising from Macau, with an exemption up to MOP 300. No provision for Macau profits tax has been made in the statements of comprehensive income as there were no assessable profits arising from Macau for the years ended June 30, 2013, 2014 and 2015, respectively.

## India

HAIP, the Company's wholly owned subsidiary incorporated in India, is subject to India corporate tax rate of 30% on its worldwide income. No provision for India profits tax has been made in the statements of comprehensive income as there were no taxable profits arising for the years ended June 30, 2013, 2014 and 2015, respectively.

## Italy

HollyCon Italy, 99% owned by the Company and incorporated in Italy, is subject to a corporate income tax at the rate of 27.5% and to a regional production tax at the rate of 3.9% based on its worldwide income. No tax provision has been made on the statement of comprehensive income as there were no taxable profits arising for the years ended June 30, 2013, 2014 and 2015, respectively.

## PRC

The Company's subsidiaries incorporated in the PRC are subject to PRC enterprise income tax ("EIT") on the taxable income as adjusted in accordance with relevant PRC income tax laws. The standard statutory tax rate of PRC EIT is 25% effective from calendar year ended December 31, 2008. All PRC subsidiaries are subject to the standard statutory tax rate except for the following subsidiaries:

### *Beijing Hollysys*

Beijing Hollysys was certified as a High and New Technology Enterprise ("HNTE") which provides a preferential EIT rate of 15% for three years each commencing January 1, 2014.

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

In February 2013, Beijing Hollysys received the “Qualified Software Development Enterprise” certificate which entitles Beijing Hollysys an EIT rate of 10% for the calendar years ended December 31, 2011 and 2012. An income tax recoverable of \$1,634 was recorded in Beijing Hollysys in 2013 since it paid its EIT based on a 15% tax rate for the calendar years ended December 31, 2011 and 2012.

*Hangzhou Hollysys*

In 2011, Hangzhou Hollysys was certified as a HNTE which provides a preferential EIT rate of 15% for three years each, commencing on January 1, 2014, respectively.

The Company’s income before income taxes consists of:

	Year ended June 30,		
	2013	2014	2015
PRC	\$67,928	\$97,931	\$134,657
Non-PRC	(7,310 )	(6,619 )	(9,430 )
	\$60,618	\$91,312	\$125,227

Income tax expense, most of which is incurred in the PRC, consists of:

	Year ended June 30,		
	2013	2014	2015
Current income tax expense	\$10,053	\$25,333	\$21,194

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Deferred income tax (benefit) expense	(1,956 )	(5,472 )	4,846
	\$8,097	\$19,861	\$26,040

The reconciliation of tax computed by applying the statutory tax rate in the PRC of 25% to the income before income taxes is as follows:

	Year ended June 30,		
	2013	2014	2015
Income before income taxes	\$60,618	\$91,312	\$125,227
Expected income tax expense at statutory tax rate in the PRC	15,155	22,828	31,307
Effect of different tax rates in various jurisdictions	898	2,709	1,286
Effect of preferential tax treatment	(5,994 )	(5,027 )	(12,453 )
Effect of non-taxable income	(5,006 )	(5,747 )	(6,770 )
Effect of additional deductible research and development expenses	(2,743 )	(2,604 )	(2,772 )
Effect of non-deductible expenses	6,436	6,379	8,402
Effect of change in tax rate	(2,968 )	-	(4,191 )
Change in valuation allowance	2,233	2,075	1,475
Tax rate differential on deferred tax items	(699 )	(2,193 )	3,139
Withholding tax on dividend paid by subsidiaries	1,248	1,381	6,028
Recognition of temporary difference not recognized in previous years	(287 )	284	323
Others	(176 )	(224 )	266
Total	\$8,097	\$19,861	\$26,040

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

Had the above preferential tax treatment not been available, the tax charge would have been increased by \$5,994, \$5,027 and \$10,167 and the basic net income per share would have been reduced by \$0.11, \$0.09 and \$0.17 for the years ended June 30, 2013, 2014 and 2015, respectively, and diluted net income per share for the years ended June 30, 2013, 2014 and 2015 would have been reduced by \$0.11, \$0.09 and \$0.17, respectively.

The breakdown of deferred tax assets/liabilities caused by the temporary difference is shown as below:

	June 30,	
	2014	2015
Deferred tax assets, current		
Allowance for doubtful accounts	\$7,799	\$6,885
Inventory provision	210	148
Provision for contract loss	869	430
Long-term assets	18	14
Deferred revenue	10,628	5,737
Deferred subsidies	1,079	570
Warranty liabilities	1,902	1,109
Recognition of intangible assets	473	107
Accrued payroll	1,042	899
Net operating loss carry forward	4,560	5,843
Valuation allowance	(4,560 )	(5,796 )
Total deferred tax assets, current	\$24,020	\$15,946
Deferred tax liabilities, current		
Costs and estimated earnings in excess of billings	\$(17,518)	\$(12,685)
Recognition of intangible assets	-	(1,246 )
PRC dividend withholding tax	(1,381 )	(4,653 )
Others	(61 )	(36 )
Total deferred tax liabilities, current	\$(18,960)	\$(18,620)
Net deferred tax assets, current	<b>\$6,687</b>	<b>\$3,214</b>
Net deferred tax liabilities, current	<b>\$(1,627 )</b>	<b>\$(5,888 )</b>

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Deferred tax assets, non-current		
Long-term assets	\$483	\$522
Deferred subsidies	1,851	1,739
Recognition of intangible assets	271	63
Warranty liabilities	-	452
Total deferred tax assets, non-current	\$2,605	\$2,776
Deferred tax liabilities, non-current		
Share of net gains of equity investees	\$(478 )	\$99
Intangible assets and other non-current assets	(2,692 )	(371 )
Total deferred tax liabilities, non-current	\$(3,170 )	\$(272 )
Net deferred tax assets-non-current	<b>\$1,806</b>	<b>\$2,581</b>
Net deferred tax liabilities-non-current	\$(2,371 )	\$(77 )

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

As of June 30, 2014 and 2015, the Company has \$25,620 and \$33,472 net operating loss, respectively which can be carried forward to offset future net profit for income tax purposes. For the amount as of June 30, 2015, \$33,657 will expire, if unutilized, from December 31, 2015 to 2019.

The Company operates mainly through its PRC subsidiaries and the valuation allowance is considered on an individual entity basis.

Under the EIT Law and the implementation rules, profits of the Company's PRC subsidiaries earned on or after January 1, 2008 and distributed by the PRC subsidiaries to a foreign holding company are subject to a withholding tax at a rate of 10% unless reduced by tax treaty. At June 30, 2014 and 2015, aggregate undistributed earnings from the Company's PRC subsidiaries that are available for distribution is approximately RMB1,836,127 (equivalent to \$276,586) and RMB2,320,060 (equivalent to \$355,454), respectively. The Company expects to distribute a portion of the earnings (approximately RMB200,000 or \$32,714) to holding companies located outside mainland China, and has hence accrued a withholding tax of \$3,271 in the year ended June 30, 2015. The remaining undistributed earnings of the Company's PRC subsidiaries are intended to be permanently reinvested, and accordingly, no deferred taxes have been provided for the PRC dividend withholding taxes that would be payable upon the distribution of those amounts to the Company. Distributions made out of pre-January 1, 2008 retained earnings will not be subject to withholding taxes.

The Chinese tax law grants the tax authorities the rights to further inspect companies' tax returns retroactively in a three year period (up to five years under certain special conditions), which means theoretically the tax authorities can still review the PRC subsidiaries' tax returns for the years ended December 31, 2010 through 2014. The tax law also states that companies will be liable to additional tax, interest charges and penalties if errors are found in their tax returns and such errors have led to an underpayment of tax.

Determining income tax provisions involves judgment on the future tax treatment of certain transactions. The Company performed a self-assessment and concluded that there was no significant uncertain tax position requiring

recognition in its financial statements. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations. Where the final tax outcome of these transactions is different from the amounts that were initially recorded, such difference will impact the income tax and deferred tax provisions in the year in which such determination is made.

There were no material interest or penalties incurred for the years ended June 30, 2012, 2013 and 2014, respectively.

## NOTE 21 - INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share attributable to Hollysys for the years indicated:

	Year ended June 30,		
	2013	2014	2015
Numerator:			
Net income attributable to the Company - basic	\$51,994	\$69,620	\$96,527
Net income attributable to the Company - diluted <sup>(i)</sup>	\$51,994	\$69,620	\$96,877
Denominator:			
Weighted average ordinary shares outstanding used in computing basic income per share	56,167,592	57,926,333	58,612,596
Effect of dilutive securities			
Convertible Bond	-	-	644,850
Share options	206,506	482,623	839,425
Restricted shares	38,371	17,686	37,332
Weighted average ordinary shares outstanding used in computing diluted income per share	56,412,469	58,426,642	60,134,203
Income per share - basic	\$0.93	1.20	1.65
Income per share - diluted	\$0.92	1.19	1.61

(i) For the year ended June 30, 2015, interest accretion related to the Convertible Bond of \$350 is added back to derive net income attributable to the Company for computing diluted income per share.



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Vested and unissued restricted shares of 39,375, 60,625 and 58,726 shares are included in the computation of basic and diluted income per share for the years ended June 30, 2013, 2014 and 2015, respectively.

The impact of the contingent consideration for acquisition of subsidiaries have not been included in the computation of diluted income per share for the year ended June 30, 2013 due to the fact that contingently issuable ordinary shares would not be issued under the terms of the arrangement if the end of the reporting period were the end of the contingency period. For the year ended June 30, 2014, as the performance target was achieved for the first instalment of the Incentive Shares for Bond, hence 648,697 shares were issuable as of June 30, 2014. These shares were included in the computation of basic and diluted income per share. However, the second installment of Incentive Shares for Bond and Premium Shares for Bond has been excluded from the computation of diluted income per share because the contingently issuable common shares would not be issued under the terms of the arrangement if the end of the reporting period were the end of the contingency period. For the year ended June 30, 2015, Bond has achieved the pre-determined performance target (note 3), and the second installment of Incentive Shares for Bond and Premium Shares for Bond with 461,107 shares and 166,471 shares respectively are issuable and have been included in the computation of basic and diluted income per share for year ended June 30, 2015.

**NOTE 22 - RELATED PARTY TRANSACTIONS**

The related party relationships and related party transactions are listed as follows:

Related party relationships

**Name of related parties**

Shenhua Hollysys Information Technology Co., Ltd. (“Shenhua Information”)  
China Techenergy Co., Ltd. (“China Techenergy”)  
Beijing Hollysys Electric Motor Co., Ltd (“Electric Motor”)

**Relationship with the Company**

20% owned by Beijing Hollysys  
40% owned by Beijing Hollysys  
40% owned by Beijing Hollysys

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Zhejiang Sanxin Technology Co., Ltd (“Zhejiang Sanxin”)

6% owned by Hangzhou Hollysys

Beijing Hollysys Machine Automation Co., Ltd. (“Hollysys Machine”)

30% owned by Hollysys Investment

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Due from related parties

	June 30,	
	2014	2015
China Techenergy	\$19,039	\$34,472
Shenhua Information	3,833	3,447
Hollysys Machine	848	1,158
	\$23,720	\$39,077

The Company's management believes that the collection of amounts due from related parties is reasonably assured and accordingly, no provision had been made for these balances.

Due to related parties

	June 30,	
	2014	2015
China Techenergy	\$2,267	\$837
Shenhua Information	1,591	818
Hollysys Machine	82	9
Electric Motor	48	49
	\$3,988	\$1,713

Transactions with related parties

Purchases of goods and services from:

	Year ended June 30,		
	2013	2014	2015
Hollysys Machine	\$973	\$1,980	\$914
Shenhua Information	365	323	368
New Huake <sup>(1)</sup>	70	-	-
Electric Motor	68	14	50
China Techenergy	-	-	1
	\$1,475	\$2,317	\$1,333

<sup>(1)</sup> The Company disposed its interest in New Huake during fiscal year 2015, and New Huake is no longer a related party of the Company as of June 30, 2015

Sales of goods and integrated solutions to:

	Year ended June 30,		
	2013	2014	2015
China Techenergy	\$17,060	\$3,136	\$21,936
Shenhua Information	1,936	2,726	2,128
Hollysys Machine	557	921	512
Electric Motor	4	2	1
	\$19,557	\$6,785	\$24,577

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

Operating lease income from:

	Year ended June 30,		
	2013	2014	2015
Hollysys Machine	\$ 66	\$ 65	\$ 41

The Company sells automation control systems to China Techenergy which is used for non-safety operations control in the nuclear power industry. China Techenergy incorporates the Company's non-safety automation control systems with their proprietary safety automated control systems to provide an overall automation and control system for nuclear power stations in China. The Company is not a party to the integrated sales contracts executed between China Techenergy and its customers. The Company's pro rata shares of the intercompany profits and losses are eliminated until realized through a sale to outside parties, as if China Techenergy were a consolidated subsidiary.

The Company sells automation control systems to Shenhua Information which is used for operations control in the information automation industry. Shenhua Information incorporates the Company's automation control systems with their proprietary automated remote control systems to provide an overall automation and control system to its customers. The Company is not a party to the integrated sales contracts executed between Shenhua Information and its customers. The Company's pro rata shares of the intercompany profits and losses are eliminated until realized through a sale to an outside party as if Shenhua Information were a consolidated subsidiary.

The Company engages Hollysys Machine to sell the Company's products to end customers. The Company pays commission to Hollysys Machine in exchange for its services. The amount of the commission is determined based on the value of the products sold by Hollysys Machine during the year.

Amounts due from and due to the related parties relating to the above transactions are unsecured, non-interest bearing and repayable on demand.

**NOTE 23 - COMMITMENTS AND CONTINGENCIES**

*Operating lease commitments*

The Company leases premises under various operating leases. Rental expenses under operating leases included in the consolidated statements of comprehensive income were \$1,909, \$2,067 and \$1,492 for the years ended June 30, 2013, 2014 and 2015, respectively.

Future minimum lease payments under non-cancelable operating leases with initial terms of one year or more consist of the following:

Years ending June 30,	Minimum lease payments
2016	\$ 1,002
2017	262
2018	615
2019	257
2020 and onwards	98
Total minimum lease payments	\$ 2,234

The Company's lease arrangements have no renewal or purchase options, rent escalation clauses, restriction or contingent rents and are all conducted with third parties.

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued**

**(Amounts in thousands except for number of shares and per share data)**

***Capital commitments***

As of June 30, 2015, the Company had approximately \$424 in capital obligations for the coming fiscal year, mainly for decoration projects of the Company's headquarters in Beijing, PRC.

***Purchase obligation***

As of June 30, 2015, the Company had \$280,055 in purchase obligations for the coming fiscal year, for purchases of inventories, mainly for fulfillment of in-process or newly entered contracts resulting from the expansion of the Company's operations.

***Performance guarantee and standby letters of credit***

The Company had stand-by letters of credit of \$580 and outstanding performance guarantees of \$77,841 as of June 30, 2015, with restricted cash of \$28,373 pledged to banks. The purpose of the stand-by letter of credit and performance guarantees is to guarantee that the performance of the Company's deliveries reach the pre-agreed requirements specified in the integrated solutions contracts. The guarantee is to ensure the functionality of the Company's own work. The disclosed amount of stand-by letters of credit and outstanding performance guarantees represent the maximum potential amount of future payments the Company could be required to make under such guarantees.

The Company accounts for performance guarantees and stand-by letters of credit in accordance with ASC topic 460 ("ASC 460"), *Guarantees*. Accordingly, the Company evaluates its guarantees to determine whether (a) the guarantee is specifically excluded from the scope of ASC 460, (b) the guarantee is subject to ASC 460 disclosure requirement

only, but not subject to the initial recognition and measurement provisions, or (c) the guarantee is required to be recorded in the financial statements at fair value.

Both the performance guarantees and the stand-by letters of credit are for the Company's commitment of its own future performance, and the outcome of which is within its own control. As a result, performance guarantees and stand-by letters of credit are subject to ASC 460 disclosure requirements only.

**NOTE 24 - OPERATING LEASES AS LESSOR**

On April 3, 2013, Beijing Hollysys entered into an operating lease agreement to lease out one of its buildings located in Beijing. The lease term is for a period of 10 years from the commencement date of September 1, 2013 and will end on August 31, 2023. The minimum rental income in the next five years is shown as below:

Year ending June 30,	Minimum lease payments
2016	\$ 1,545
2017	1,591
2018	1,639
2019	1,688
2020	1,739
Total minimum lease payments to be received in the next five years	\$ 8,202

The minimum lease payment receivable after five years is \$5,856.



**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)****NOTE 25 - SEGMENT REPORTING**

The chief operating decision makers have been identified as the Chairman, Chief Executive Officer and Chief Financial Officer of the Company. The Company organizes its internal financial reporting structure based on its main product and service offerings.

Based on the criteria established by ASC 280, *Segment Reporting* (“ASC 280”), the Company has determined that the reportable segments of the Company consist of (1) industrial automation (“IA”), (2) rail transportation (“Rail”), (3) mechanical and electrical solutions (“M&E”) and (4) miscellaneous, in accordance with the Company’s organization and internal financial reporting structure. The chief operating decision makers assess the performance of the operating segments based on the measures of revenues, costs and gross profit. Other than the information provided below, the chief operating decision makers do not use any other measures by segments.

Summarized information by segments for the years ended June 30, 2013, 2014, and 2015 is as follows:

	Year ended June 30, 2013				
	IA	Rail	M&E	Miscellaneous	Consolidated
Revenues from external customers	\$211,713	82,344	36,132	18,866	349,055
Costs of revenue	131,444	46,826	30,362	16,754	225,386
Gross profit	\$80,269	35,518	5,770	2,112	123,669

  

	Year ended June 30, 2014				
	IA	Rail	M&E	Miscellaneous	Consolidated
Revenues from external customers	\$224,366	178,134	108,846	9,986	521,332
Costs of revenue	143,645	104,055	93,459	4,549	345,709
Gross profit	\$80,721	74,079	15,387	5,437	175,623

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	Year ended June 30, 2015				Consolidated
	IA	Rail	M&E	Miscellaneous	
Revenues from external customers	\$213,252	193,274	110,030	14,823	531,379
Costs of revenue	119,520	97,503	93,452	6,503	316,977
Gross profit	\$93,732	95,771	16,578	8,320	214,402

The Company's assets are shared among the segments thus no assets have been designated to specific segments.

The majority of the Company's revenues and long-lived assets other than goodwill and acquired intangible assets are derived from and located in the PRC. The following table sets forth the revenues by geographical area:

	Year ended June 30,		
	2013	2014	2015
Revenues:			
PRC	\$285,978	\$393,596	\$410,644
Non-PRC (including Hong Kong)	63,077	127,736	120,735
	\$349,055	\$521,332	\$531,379

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**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)**

The following table sets forth the long-lived assets other than goodwill and acquired intangible assets by geographical area:

	June 30,	
	2014	2015
Long-lived assets other than goodwill and acquired intangible assets		
PRC	\$ 102,181	\$ 95,779
Non-PRC (including Hong Kong)	12,059	13,068
	\$ 114,240	\$ 108,847

**NOTE 26 - ENDORSEMENT OF NOTE RECEIVABLES**

The Company endorsed bank acceptance bills to its suppliers as a way of settling accounts payable. The total endorsed but not yet due bank acceptance bills amounted to \$43,421 and \$37,669 as of June 30, 2014 and 2015, respectively. The endorsement of bank acceptance bills qualify as deemed sales of financial assets according to ASC 860, *Transfer and Servicing* (“ASC 860”) because the bank acceptance bills have been isolated from the Company upon transfer, the transferee of the bank acceptance bills have the rights to pledge or exchange, and the Company has no control over the bank acceptance bills upon endorsement. As a result, bank acceptance bills are derecognized at the time of endorsement.

**NOTE 27 - CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY**

Under the PRC laws and regulations, the Company’s PRC subsidiaries’ ability to transfer net assets in the form of dividend payments, loans, or advances are restricted. The amount restricted was RMB455,116 (equivalent to \$66,223) and RMB 497,789 (equivalent to \$73,209) as of June 30, 2014, and 2015, respectively.

The following represents condensed unconsolidated financial information of the parent company only:

### CONDENSED BALANCE SHEETS

	June 30,	
	2014	2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$-	\$8,437
Time deposits with original maturities over three months	-	14,721
Amounts due from subsidiaries	147,975	114,311
Prepaid expenses	56	50
Total current assets	148,031	137,519
Investments in subsidiaries	373,682	532,136
Total assets	\$521,713	\$669,655
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accrued payroll and related expense	\$11	\$18
Accrued liabilities	1	323
Amounts due to subsidiaries	33,227	70,642
Total current liabilities	33,239	70,983
Long term loan	-	19,572
Total Liabilities	33,239	90,555
Equity:		
Ordinary shares, par value \$0.001 per share, 100,000,000 shares authorized; 57,554,824 and 58,358,521 shares issued and outstanding as of June 30, 2014 and 2015, respectively	58	58
Additional paid-in capital	173,765	192,768
Retained earnings	275,639	348,689
Accumulated other comprehensive income	39,012	37,585
Total equity	488,474	579,100
Total liabilities and equity	\$521,713	\$669,655

**HOLLYSYS AUTOMATION TECHNOLOGIES, LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2013, 2014 AND 2015 – continued****(Amounts in thousands except for number of shares and per share data)****CONDENSED STATEMENTS OF COMPREHENSIVE INCOME**

	Year Ended June 30,		
	2013	2014	2015
General and administrative expenses	\$2,824	\$3,721	\$3,169
Loss from operations	(2,824 )	(3,721 )	(3,169 )
Other income (expense), net	218	-	(35 )
Interest income	-	-	1
Interest expenses	-	-	(463 )
Foreign exchange gain	1,620	263	238
Equity in profit of subsidiaries	\$52,980	\$73,078	\$99,955
Income before income taxes	51,994	69,620	96,527
Income tax expenses	-	-	-
Net income	51,994	69,620	96,527
Other comprehensive income, net of tax of nil			
Translation adjustments	4,157	2,140	(1,427 )
Comprehensive income	\$56,151	\$71,760	\$95,100

**CONDENSED STATEMENTS OF CASH FLOWS**

	Year ended June 30,		
	2013	2014	2015
Net cash used in operating activities	\$ -	\$ -	\$ (397 )
Net cash used in investing activities	-	\$ -	\$ (4,402 )
Net cash provided by financing activities	\$ -	\$ -	\$ 13,236
Net increase in cash and cash equivalents	\$ -	\$ -	\$ 8,437
Cash and cash equivalents, beginning of year	\$ -	\$ -	\$ -
Cash and cash equivalents, end of year	\$ -	\$ -	\$ 8,437

Basis of presentation

For the presentation of the parent company only condensed financial information, the Company records its investment in subsidiaries under the equity method of accounting as prescribed in ASC 323, *Investments—Equity Method and Joint Ventures* (“ASC 323”). Such investment is presented on the balance sheets as “Investment in subsidiaries” and the subsidiaries’ profit as “Equity in profit of subsidiaries” on the statements of comprehensive income. The parent company only financial statements should be read in conjunction with the Company’s consolidated financial statements.

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