China Fire & Security Group
Third Quarter 2009 Earnings
November 9, 2009

Operator: Good day and welcome to the China Fire & Security Group Third Quarter 2009 Earnings Conference Call. Please be aware that today's conference is being recorded. At this time I'd like to turn the conference over to Michael Tieu of ICR. Please go ahead.

Michael Tieu: Thank you everyone for joining us for the China Fire & Security Group's Third Quarter 2009 Earnings Call. With us today is Brian Lin, China Fire's Chief Executive Officer and Robert Yuan, China Fire's Principal Accounting Officer.

Before we get started, I am going to review the Safe Harbor statement regarding today's conference call. This conference call may contain, in addition to historical information, forward-looking statements within the meaning of the Federal Securities laws regarding China Fire. Forward-looking statements, including statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, other than statements that are historical in nature. These forward-looking statements are based on current management's expectations and are subject to risks and uncertainties that may result in expectations not being realized and may cause actual outcomes to differ materially from expectations reflected in these forward-looking statements. Potential risks and uncertainties include product and service demand acceptance, changes in technology or economic conditions, the impact of competition and pricing, the impact of government regulations, and other risks contained in the statements filed from time to time with the SEC.

All such forward-looking statements, whether written or oral, and whether made by or on behalf of the company are expressly qualified by the cautionary statements. Because forward-looking statements are subject to risks and uncertainties, we caution you not to place undue reliance on these statements. Forward-looking statements made during this conference call only represent management's estimates as of today, August 10, 2009. China Fire & Security Group assumes no obligation to update these projections in the future as market conditions change. For those of you unable to listen to the entire call at this time, a recording will be available via webcast for 360 days on our corporate website, www.chinafireandsecurity.com.

At this point, I would like to introduce Brian Lin, Chief Executive Officer of China Fire & Security Group. Brian?

Brian Lin: Thank you very much, Michael. Good morning everyone to those in the U.S. and good evening to those participants in Asia.

Welcome to our Third Quarter 2009 Conference Call. Today we will discuss our financial results, talk about our recent developments and our strategic plans and conclude with our outlook for the remainder of 2009.

Despite a number of deferred projects in our core iron and steel market, I am satisfied with our third quarter performance as we achieved record revenue and solid profit. During the quarter we secured contracts from iron and steel plants, power plants, petrochemical plants, and we also succeeded in significantly growing our international markets with notable wins in the fast emerging power market in India.

Before we get to the details of our third quarter 2009 financial results, allow me to share with you highlights of our achievements during this quarter as we continue to reach new records in our business. We achieved record high revenue of 24.8 million which grew 48.2%, or $8.0 million from 16.7 million, for the same period of 2008. Our gross profit increased by 41.9%, or 4.1 million to 14.0 million, compared to 9.9 million for the third quarter of 2008. Our operating income increased by 39.2% or 2.4 million to 8.5 million for the third quarter of 2009. Our net income increased 17% year-over-year to 7.6 million for the third quarter of 2009.

We have made significant progress in the international market. To date, we have one contract in the Indian market worth a total more than $10 million. At this point however, let me turn the call over to Robert for a detailed discussion on our third quarter financial results. Afterward, I will try to discuss our recent developments and our strategic plans and conclude with an update on our guidance for the remainder of 2009. Robert?

Robert Yuan: Thank you, Brian. In the third quarter of 2009 we once again solidly grew our revenue, expanded our profit, and maintained a strong balance sheet. Our revenue for the third quarter of 2009 grew 48.2% to $24.8 million U.S. compared to 16.7 million for the third quarter of 2008.

During the third quarter we generated revenue from 205 Total Solutions, product sales and maintenance contracts, up from 163 contracts from third quarter of 2008. System contracting revenues increased 23.3% to 18.7 million, derived from 101 solution contracts, up from 15.2 million generated from 97 contracts in the third quarter of 2008. This increase in revenue from system contracting projects was primarily attributable to the increase in number of system contracting projects we executed and the successful execution of large sized iron and steel projects from Jinan Iron & Steel Group and Capital Iron & Steel Group for the third quarter.

Our product sales grew significantly to 5.4 million with 45 contracts executed in this quarter, as compared to $1 million U.S. with 28 contracts executed in the same period of last year. The increase in our product sales was mainly attributable to the increase in our linear heat detectors and other fire protection products in China and our new expansion in India during the period. Driven by our expanded customer bases, our maintenance and service revenues also increased by 27.8% to $0.8 million U.S., deriving from 59 contracts we executed for the third quarter 2009, compared to 0.6 million of 38 contracts a year ago. As we continue to fulfill large contracts with our core customers, the iron and steel industry remained the largest vertical, contributing approximately 74.6% of total third quarter revenues. Power and nuclear have become one of the largest verticals in the third quarter, contributing approximately 13.6% of revenues. Petrochemical and other verticals contributed approximately 11.8% of our revenue during the quarter.

Our third quarter gross profit increased by 41.9% or 4.1 million to $14.0 million U.S., from 9.9 million in the same period of the previous year. Our gross margin for the third quarter of 2009 was 56.4% compared to 58.9% for the same period of 2008. The decrease in the gross margin was mainly attributed to the change of product mix in the quarter as a lower percentage of self-manufactured proprietary products has been sold through our Total Solution and product sales contracts during this quarter. Each contributed to a lower gross margin.

Our selling expenses was $2.5 million U.S. for third quarter 2009 as compared to 1.7 million for third quarter 2008, an increase of approximately 0.8 million or 43.7%. The increase in our selling expenses was mainly attributable to the increase in our filled related activities in iron and steel, power generation, and the petrochemical industries and our continued effort to expand our business into new industries, including nuclear power, transportation and international markets.

General administrative expenses were $2.4 million U.S. for the third quarter of 2009 as compared to 1.1 million for the same period in 2008, an increase of approximately 1.3 million, or 113.3% due to higher employee salary and compensation and increasing bad debt expenses in this period.

R&D expenses increased to 0.4 million as compared to 0.8 million in the same period 2008, mainly attributed to the variance in the expenditure required in different product development cycles.

Operating income for the third quarter grew 39.2% to 8.5 million from 6.1 million for the same period last year. Operating margin in the third quarter of 2009 was 34.4% versus 36.6% a year ago due to a lower gross margin during the period.

Total other income was 335,000 for the third quarter of 2009 compared to 324,000 for the same period of 2008.

Our provision for income taxes was approximately 1.3 million in the third quarter of 2009 with effective tax rate of 15.0% compared to approximately $6,700 U.S. tax credit for the same period last year. This significantly increased our provision for income tax was mainly due to the fact that Sureland Industrial, our major operating subsidiary, began to pay 4.5% of its income tax rate, starting from the first quarter of 2009 after the expiration of its tax exemption period.

Our GAAP net income for the third quarter of 2009 grew 11—17.0% or $1.1 million U.S. to $7.6 million U.S. as compared to 6.5 million for the same period of 2008. As a result, our fully diluted GAAP EPS grew 16.5% to $0.27 from $0.23 a year ago.

At the end of the third quarter, our total backlog (inaudible) was $75 million U.S. from $85 million U.S. in the previous quarter. The decrease in our backlog on a quarterly basis was mainly attributed to a) the timing of the large contract signings during the quarter and b) the government's limit on the expansion of new production capacities in the iron and steel industries, resulting in the proponents of build out of a number of large iron and steel projects. However, as Brian will provide you with details later on the call, we are witnessing accelerated effort by our largest customers to retrofit existing iron and steel plants which provided us with guarded optimism as these retrofit projects could result in significant revenue opportunities for China Fire in the future.

Our product lead backlog at end of the third quarter, iron and steel industry was still the major vertical and contributed approximately 50% of backlog. Power generation and nuclear power together contributed approximately 40% of current backlog. Petrochemical and other verticals together represented the remaining 3% of our backlog and the rest part of the backlog came from the international contracts. We expect to convert a majority of the current backlogs to revenue in the next 12 months.

Now I would like to turn your attention to our balance sheet and cash flows. Because the balance sheet is a snapshot at a moment in time, I'd like to address basically, only line items that have significantly changed or that I believe can have naturally impact to our ongoing operation.

During the third quarter the net cash used by our operating activities was $4.6 million U.S. compared to 0.4 million. Net cash provided by operating activities during the second quarter of 2009 is decreasing. The net cash provided by operating activities was mainly attributed to the increase in account receivables and the cost and estimate earnings in excess billing. At the end of this quarter we had net cash of 28.5 million which increased by 0.7 million at the end of the second quarter 2009.

Our current receivable increased by 4.1 million to 28.3 million as we proactively offered our top tier customers with extended payment terms and experienced relatively slower cash payments from smaller iron and steel clients. As a result, our DSOs increased slightly to 130 days versus 128 days in the previous quarter. We know that approximately 80% of our receivables are held by China's top tier industrials and the state owned enterprises with strong payment histories. We have counted on that our current receivables are collectible and do not anticipate major write-offs in the future.

However, we have accelerated our cash collection activities in the fourth quarter of 2009 as the cash flow of some of our customers are improving and trying to generate positive operating cash flow for the full year. The increase of 6.2 million in cost and estimated earnings in excess billing in the third quarter of 2009 was mainly due to the increase in the aggregate value of projects where we have recognized revenue more than we have billed the customer. Inherent to U.S. GAAP, we recognize project revenue based on percentage-of-completion and bill customers based on the payment schedule that has different milestones than in the project contract.

Our working capital increased by approximately 8.9 million to $84.1 million U.S., up from 75.2 million as of June 30, 2009. We currently have no bank loans or debt and as such, our total shareholders' equity increased to 101.0 million as of September 30, 2009, up by 93.1 million from the end of the second quarter of 2009.

In summary, I'm very pleased with our solid financial performance during the third quarter of 2009. That concludes my financial review so let me turn the call back to Brian for a discussion on our recent developments and our strategic plans. Brian, please.

Brian Lin: Thank you, Robert. Let me now share with you our growth strategies and the specific macroeconomic trends that continue to validate our gain. China's economy in general has seen a strong boost from the government's stimulus package and recent data shows that the country is on track to achieve and perhaps even exceed its positive 8% growth this year. Though the government has recently held back on further expanding production capacities in the iron and steel industry, we are increasingly excited about the large contract opportunities to retrofitting existing production plants of our tier one iron and steel customers.

Additionally, we continue to witness higher government spending on improving and expanding the nation's public works infrastructure. We anticipate continued government support to substantially expand the nation's power generation and transmission capacity. Similarly, we anticipate sustained momentum in the transportation and petrochemical verticals.

We are also excited about the fast developing power generation market in India and other developing economies throughout Asia. As such, we remain focused on executing the strategies that we have consistently outrun and bypassed throughout 2009.

Firstly, we continue to leverage our leading position in the iron and steel industry. Recently the National Development and Reform Commission of China, or NDRC has began to curb potential over capacity in China's iron and steel industry by delaying some large steel projects that have previously been approved by the central government. Consequently, while we won new contracts on winning bids worth approximately 7.3 million in the iron and steel industry during the third quarter, there were a number of large contracts deferred. We continue to command firm pricing in competitive wins and as such, our profit margin for iron and steel remains stable and we have focused on top tier customers that are less price sensitive.

As we mentioned in the previous earnings call, the major amendment of the fire protection law issued by the Chinese government and the mandatory national standard of product design for fire protection and prevention for iron and steel metallurgy enterprises, strictly require all fire protection products to comply with the national standards and to pass the compulsory product certification via its qualified certification institution. Currently, most of China's large steel plants were constructed some years ago and many of them do not have code compliant fire protection facilities. Further, many fire protection systems are facing considerable aging after decades of operation, rendering them inadequate according to the new, mandatory requirement.

We have been actively working with the steel high end customers to provide overall retrofitting solutions and services for their existing plants and facilities to be in compliance with the new fire codes in their respective industries. Our customers also prefer our Total Solution approach which provides overall planning of retrofitting of most existing plants, as well as our high economies of scale which we can pass the cost savings from sharing of resources directly to our customers, allowing the retrofitting projects we are also provide comprehensive fire protection maintenance safety services to our customers.

Currently, each our customers may have dozens of maintenance services providers for different plants and facilities and consequently, quality of service can vary greatly from one service provider to another. Whereas with our comprehensive, network-based monitoring system we can provide our customers with a single point of access that consolidates all fire-related information from each and all of our customers' entire operations. With (inaudible) ubiquity our customer can access key safety information and monitor operations from anywhere at any time. As a result, we have discovered a great market potential for retrofitting the fire protection systems of existing large iron and steel plants.

We are very excited about these new retrofitting opportunities and believe that the strong revenue potential could overcome a temporary deferment of large, new projects mentioned earlier. We anticipate signing our first major retrofit contract in the near future. In addition to tier one customers, we're also working with a significant number of medium sized iron and steel companies who are competitive in the market place with specialized, high end products. These companies continue to successfully grow their business by developing and manufacturing new, innovative products.

Secondly, we continue to expand our customer base in the power sector, including thermal, hydro, nuclear, and transmission. In 2008 China invested more than 576 billion RMB in infrastructure construction of power industry, of which investment in the nation's electric grid infrastructure accounted for more than 50% of the total infrastructure investment, exceeding total investments in power generation. In 2009, our data indicates that from January to September, investment in electricity grid construction increased by 19% year-over-year to more than 219 billion RMB. By 2010 with expected completion of construction for ultra high voltage electric grid, cross-region transmission capacity will reach 17 million kilowatts which is five-fold of the capacity in 2005.

The continued development of the nation's electric grid has greatly accelerated the construction of large scale substations and high voltage power cable tunnels. These underground power cable tunnels have high degree of fire risk which require advanced fire protection solutions, representing considerable business opportunities for China Fire. We are very excited about this growing market and believe that China Fire will directly benefit from the infrastructure, development and upgrade. Recognizing this potential market, we have been actively investing and expanding our vertically focused, technical and sales team for this sector. We are pleased with our progress in the power generation vertical as we won contracts totaling 1.7 million in the third quarter of 2009. We anticipate strong growth in this vertical in 2010 as we have strong track records in all segments of power industry and have a portfolio of competitive products that are critical components of the total fire protection solutions.

Thirdly, we are actively pursuing business opportunities in the international market. We are very excited about our momentum in India which to date, we have won more than $10 million worth of contracts, including our recent contract win with NTPC, the largest power company in India. Further, we intend to market our patented linear heat detectors and water mist systems in India soon. We believe that the Indian government's huge infrastructure investments in constructing and upgrading the nation's power plants, iron and steel plants, airports and transportation systems will create ample revenue prospects for China Fire in the Indian market. We are very confident that our U.S. certified proprietary patented products will allow China Fire to further solidify our competitive position, enhance our brand awareness, and secure more contract wins in the international markets.

Fourthly, we continue to diversify our revenue sources from other verticals, including petrochemical, transportation, and large open space buildings. We expanded our contract with Shenhua Baotou Charcoal Chemical Industry Company, Limited to 2.5 million in the third quarter from 1.5 million in the first quarter of this year. We're delighted that our technical strength has enabled us to gain additional revenue opportunities from our existing customers.

Fifthly, we will continue to invest in technology innovation and influence the development of new fire standards and code enhancements. We believe the stricter fire protection law mentioned earlier will accelerate demand for advanced fire safety products and services and thus drive more demand for our innovative and industry-leading solutions. Moreover, we believe that our close participation in developing new standards and code enhancements will continue to elevate our brand and enhances our competitive position.

Certainly we own a comprehensive portfolio of patents in China and internationally and we believe our patented proprietary products will enhance our ability to maintain healthy margins and strongly support our future business growth in fully expanding our product sells into other industrial verticals. Our recently established Baotou electric product center is on track to complete the development of several new innovative fire detection products which are targeted to be released before the end of the year. This new product include our next generation Tri-Band Infrared Flame Detector or next generation Infrared Combustible Gas Detector and Fiber-Optic-Based Linear Heat Detectors. We are in the final stage of completing the innovation of a workshop in Beijing in anticipation of scaled manufacturing of this product.

Now let me share with you our outlook for 2009. We continue to be excited with our growth prospects and will continue to command firm pricing for our Total Solution, as our gross margin continues to exceed our target range of 45 to 55%. We intend to sustain our current momentum and believe that our technical strength and leading market position will enable us to seize more growth opportunities from the world two most dynamic economies, China and India.

Reflecting our solid, third quarter 2009 financial results, we are reaffirming our revenue guidance of 88 million to 95 million for the full year 2009 and our EPS of $1.00 to $1.05 for diluted share, based on 28.3 million shares. Net income is estimated to grow to a range of 28.3 million to 29.7

million. We're keeping our 2009 effective tax rate assumption of 13.5% as compared to our effective tax rate in 2008 of 22%.

In closing, we are confident about our strategy and our technical expertise in fire safety. As we continue to grow our leading brand, distribution, customer base, Total Solution offering, and competitive advantages in the rapidly growing industrial fire protection industry. We continue to be bullish about our core iron and steel market. Although the major projects have been temporarily deferred, we are very excited about opportunities in the new retrofitting opportunities with our tier one customers and continue to actively pursue many iron and steel projects in our pipeline.

This concludes my prepared remarks for the third quarter of 2009. Operator, you may now open the call for questions. Please begin with the first question.

Operator: Thank you. First off, I wanted to instruct our participants, the question and answer session is conducted electronically. If any one would like to ask a question at this time please do so by pressing the star key, followed by the digit one on your touchtone telephone. If you are utilizing a speaker phone please make sure your mute function is turned off to allow your signal to reach our equipment. We will proceed in the order that you signal us and we will take as many questions as time permits. Once again, please press star, one on your touchtone telephone to ask a question.

And we'll take our first question from Michael Cox.

Michael Cox: Thank you very much. Good evening, gentlemen.

Brian Lin: Hi Michael.

Michael Cox: My first question is on the retrofit component of the iron and steel market. I wonder if you could discuss the types of—or I should say the size of potential contracts you would be pursuing and the margin profile of those contracts. Are they similar to the new construction market or would they differ in some way?

Robert Yuan: Okay, these retrofitting opportunities are to our top tier customers and it's for their entire plant and so, I mean, but it could be in different phases like phase one and phase two but it is for their—all their existing facilities. So this is comparable to the new projects which might involve only a few, one, or a couple of plants. In terms of the size, it's very hard to say at this point. But I think the—it will be meaningful sizes. It involves, sometimes could be 30 to 50 plants.

Michael Cox: That's helpful and in the past it seemed that there was not enough enforcement to motivate the iron and steel operators to retrofit. Has something changed that is leading to this activity now?

Brian Lin: Yes, I think one of the major triggers is the adoption of the amendment to the fire protection law in China in—passed May, where the principals of all the general managers of the enterprise is personally liable for any fire casualties, especially when it involves human casualties. And so this has increased awareness of fire safety across all the societies. And when it comes to the iron and steel industry, that is an industry where we have worked for the last almost 15 years and so we do have inference to these management team and also, it's part of the current government policy to curb the new construction of iron and steel plants and this—and possibly (inaudible) is cause for to encourage these iron and steel companies to invest in technology innovation and retrofitting of their existing facilities to manufacture or produce new product. So that could also prevent and provide them the opportunity and the incentives to look at their backyards and look at all these fire potential hazards and make further improvements based on the new fire codes in the iron and steel industry.

Michael Cox: That's very helpful. The—or one question on your India efforts, could you talk about the margin profile of what you're bidding on in India? Does it fall within your long term gross margin guidance range or perhaps, above or below?

Brian Lin: The India markets at this point, we are following mostly the power plants in that build out across India and we do have quite a portfolio of potential projects in our pipeline, so we have signed contracts about a little bit over $10 million and we do expect more project wins in 2010. We and certainly in 2010 we are also going to sell our proprietary products, our linear heat detectors, our water mist systems and we're also going to expand into the iron and steel industry in India.

As far as the margins, I think right now it's leading the margins that we expected from the Indian market. We are really happy so far.

Michael Cox: Okay that's great and my last question is on receivables. It ticked down here a little bit here in the quarter sequentially. Just nice to see, I'd just be curious what you're seeing from payment terms. I know earlier this year it was a bit of a struggle with some of your larger iron and steel customers.

Brian Lin: The collection, the cash collection is still a priority for the company. I think China now, even though the anticipated GDP growth is going to be about 8% but the—from the overall financials perspective of our major customers, mainly these iron and steel companies, they are still not as—they don't have as good cash flows as they used to have, so they are still a little bit cautious in paying out. So although our cash collection, it's okay but I think there's still room for improvements and we are working with our sales team and working with customers and try to move a better cash collections from our existing projects.

Michael Cox: Okay, thank you.

Operator: And before moving on to the next question in the queue, I'd like to remind the telephone audience, again that is star, one if you'd like to ask a question at this time.

We'll hear next from John Ma.

John Ma: Good evening, Brian and Robert.

Brian Lin: Hi John.

Robert Yuan: Hi John.

John Ma: Hi. A couple of questions, back to the margin—sorry—I apologize. I jumped on the call a little bit late. I'm not sure if it was discussed. I noticed your gross margin for your product sales was down compared to your Q2 from 77% to like a 52%. Can you elaborate a little bit more or do you see this more, you know, within your normal range or is kind of a transitory? You see a margin improvement going forward.

Brian Lin: I think this number is still fairly good, in comparison to our typical, kind of range of 45 to 55%. I think the gross margins of these product sales varied quarter-by-quarter, mostly because the product sales includes not only our proprietary product but also products that we source from third parties that goes to into certain project. So and especially when we are in different sectors, our margins, part of the integrated product sales margins for different industries varied. And as I said, in any given quarter, depending on the product delivery and depending on what project had been recognized in the certain quarter, it is hard to predict like what exactly the number will be.

John Ma: Okay. Now the other question about margin is how—what is a typical gross margin profile for the power plant project versus the steel?

Brian Lin: John, unfortunately we have not disclosed these gross margins on the kind of vertical basis and I think it's the gross margins for power plants are still over than gross margins for steel, in iron and steel industry. Most—one of the main reasons is in the iron and steel industry the usage of our proprietary products, our linear heat detector and water mist system, are much more than in the power plant.

John Ma: Okay. The other question is you mentioned the tax rate. What is your tax rate for the next two years, 2010 and ’11?

Robert Yuan: I think for the next two years, you know, we do see enjoying 15% tax benefit. So, the tax rate, income tax rate for the Sureland Industrial will be 12.5%. But I think for a model, when you evaluate our business maybe you can use an effective tax rate around 13.5% or maybe around 14%. That would be conservative.

John Ma: Okay and also, in during the quarter, you formed two companies, one in Shenhua, one in Beijing. Can you, you know, tell a little bit more about your strategy, you know, the purpose of forming a new company?

Brian Lin: For the company in Shenhua, is mostly related to the low end—low to mid end linear heat detector market in China. Sureland brand, it’s a leading brand. We really think that it’s going to be a high end brand in China. However, we do have smaller customers, especially small iron and steel companies, smaller fire generation plants and certain industrial facilities where customers are very price sensitive and that’s why we have—we work with the company in Shenhua to jointly promote the low end, low to mid end linear heat detector products in China.

The company in China that is just for, mainly for the investment purpose. We set it up so that we can—it’s just for the investment purpose.

John Ma: Okay, thank you.

Operator: Before moving on to the final question currently in queue, I would like to remind our telephone audience one final time, again, that is star, one if you have a question at this time.

We’ll move on to the final question currently in queue coming from Adele Mao.

Adele Mao: Hi, I actually just came on the call. I apologize if you had already covered this topic. I was wondering if you could just discuss the competitive landscape in India. Whom do you compete with in that market and how does your product margin compare to what the product margin is for China domestic market?

Brian Lin: Okay, thank you, Adele. In linear India market we are competing mostly with multinationals in India, companies like Tyco and Keyda (sp?) and other companies. Some of them are local companies in India but they’re all fairly sized companies. I think our track records in China and our products that are being used in the Chinese power plant provide us with a lot of advantages in competing in the Indian market. And so we are being able to win projects worth about $10 million so far and we expect to do much more in 2010.

In terms of gross margins, they are similar to what we have in China.

Adele Mao: Okay, that's very helpful. Thank you, Brian.

Brian Lin: Okay, Adele.

Operator: It will be just one moment until we assemble our queue for the next question. And moving on, our next question comes from Edward Hemmelgarn.

Edward Hemmelgarn: Hi Brian. It's Edward Hemmelgarn, just wanted to just talk a little bit more about the products gross margin. It's a little surprising just about how it bounces around all over the place. I'm not trying to say one is bad or the other, it's just, you know, you typically, I mean a company is going to have a little bit more consistent product gross margin, you know, perhaps more so than a system consulting or contracting project gross margin but I'm—can you tell us what causes the product gross margin to bounce all over the place?

Brian Lin: Okay Ed. We actually explained that in our previous MD&A section for—in previous quarterly or annual reports. The product sales includes both our proprietary products of linear heat detectors and water mist systems but also, products from third parties as part of the integrated product sales for our customers. So, you're right. For our proprietary products, our gross margins are fairly, call it consistent. But when it comes to combined, the margins with third parties then the gross margins change from one project to another. So these product, that's why in our gross margin for product sales varies sometimes can be significant from one quarter to another is because the revenue recognized from different product contracts, the composition of our proprietary products or third party products are different in this quarter versus the quarter before.

Edward Hemmelgarn: Okay thanks. Do you think the—another question just is on these retrofit projects? Would they just be, you know, for the companies themselves, the steel companies, would they primarily be just retrofit of the fire detection and prevention part of the steel mill or will the projects involve much more of an enhancement of the overall steel mill complex? I mean for, you know, doing a lot of other things than just fire related.

Brian Lin: Ed, it could be both in the projects that we are currently talking with the customers they are. They certainly have their overall plan for fire protection system. That's the portion we have been discussing with the customer. And certainly, they might have retrofitting of some of their entire plant but that, we don't really know but I think that is certainly what's going on in many iron and steel plants now, retrofitting their existing plants so that they can be more competitive. They are more kind of environmental friendly, et cetera.

Edward Hemmelgarn: Well, would you expect these, the retrofits to once they are decided upon, to get a pretty quick implementation schedule, perhaps more so than a new steel mill or will it be a similar length of time?

Brian Lin: I think for this retrofitting project is going to be over a couple of years just because of number of plants, the number of buildings that's been involved. But I think in terms of the speed of revenue recognition, I think it could be quicker than a typical new power—new iron and steel plant.

Edward Hemmelgarn: Okay, thanks.

Brian Lin: Okay.

Operator: And with no further questions in the queue, this will conclude today's question and answer session. For any additional or concluding remarks, I'd like to turn the conference back over to Brian Lin.

Brian Lin: Okay. On behalf of the entire China Fire & Security management team, we want to thank you and your interest and participation on this call. If you have any interest in visiting our office in Beijing, please let us know. This concludes our Third Quarter 2009 Conference Call.

Operator: Once again, thank you all for your participation. This does conclude today's event.