

China Fire & Security Group, Inc. ([CFSG](#))
Q2 2008 Earnings Call Transcript
August 13, 2008 8:00 am ET

Executives

Brian Lin – CEO

Robert Yuan – Chief Accounting Officer

Analysts

Chenyi Lu – Brean Murray, Carret & Co.

Michael Cox – Piper Jaffray & Co.

Adele Mao – SIG Susquehanna Financial Group

John Ma – Roth Capital Partners

Edward Hemmelgarn – Shaker Investments

Presentation

Operator

Mr. Yuan, you have been connected to your conference. As a reminder, participants are in a listen-only mode and today's call is being recorded. Please go ahead, sir.

Robert Yuan

Thank you, Andrew. Thank you and welcome everyone to the China Fire & Security's 2008 second quarter earnings conference call. The press release for the result of the second quarter 2008 has been released already. Joining me from China Fire today is Mr. Brian Lin, CEO of China Fire & Security Group.

Before we get started, I'm going to read a disclaimer about forward looking statements. This conference call may contain, in addition to historical information, forward-looking statements within the meaning of Federal Security Laws regarding China Fire. Forward-looking statements include 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 reflecting these forward-looking statements.

Potential risks and uncertainties include product and service demand acceptance, changes in technology and economic conditions, the impact of competition and pricing, the impact of government regulations, and other risks contained in these statements filed from time-to-time with SEC. All such forward-looking statements, whether written or oral, and whether made by or on behalf of the company, are expressively 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, May 13 [ph], 2008.

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 this entire call

at this time, a recording will be available via webcast for 360 days on our copy website, www.chinafiresecurity.com.

Now, I'd like to turn the call over to Mr. Brian Lin. Brian, please.

Brian Lin

Thank you, Robert. Good morning, ladies and gentlemen and good morning – good evening to those of you who join us from China or Hong Kong. Thank you for participating in our second quarter 2008 conference call. We are very pleased to report that the Olympic games are not the only places where records have been set. Our company has recorded a very strong quarter as both our revenue and net income reaching another record high.

We have successfully grown our business organically as we continue to build China Fire as the leading provider of industrial fire protection total solutions, products and services, which are mandated for all industrial plants and public facilities in China. Before we get to the details of the second quarter financial results, I would like to share with you the highlights during this quarter.

First of all the financial highlights. In the second quarter of 2008, our revenue increased to \$16.7 million, up 44.2% from \$11.5 million in the second quarter of 2007. This brings revenues for the first half of the year to \$31.4 million, up from \$21 million from the same period of 2007. Our GAAP net income reached a record \$6.7 million for the second quarter of 2008, as compared to approximately \$4.2 million net income for the same period of 2007, which represents an increase of 57.4%.

Excluding one time non-cash gain of \$0.4 million for the change in fair value of our derivatives in the second quarter of 2007, our non-GAAP net income for the second quarter of 2008 increased 72.5% in comparison to the non-GAAP net income for the second quarter of 2007. Our fully diluted EPS for the second quarter 2008 is \$0.24 as compared to \$0.16 for the same period of 2007, an increase of 51.6%.

Secondly, on the new orders and new business front, during the second quarter of 2008, we announced that China Fire won two new contracts from Wuhan Iron & Steel Group, the fourth largest steel company in China with contract values totaled \$8.3 million. Yesterday, we announced that China Fire won a \$4.7 million contract from Xinyu Iron and Steel Co., the 23rd largest steel company in China. Xinyu is located in Jiangxi province and is a new client of China Fire.

The Xinyu project is one of the major projects we disclosed that we were pursuing during our last quarter's conference call. We're very pleased that we're not only winning repeat business from our existing top tier clients, but also new business from other top tier iron and steel companies. China Iron and Steel Association has claimed that by 2010, the number of iron and steel enterprises will be decreased greatly in the top 10 enterprise groups in the country, with over 50% of gross crude steel production of China for a large scale iron and steel companies with capacity of over 50 million tons will be formed.

According to the CISA data, profits in iron and steel industries were mainly concentrated in the country's top 20 producers, which amounted to 51.7% of the 2007 figure. We are proud to say that most of the top producers are our client, including Baosteel, Anshan Iron and Steel, Wuhan Iron and Steel, Ma An Shan Iron and Steel,

etc., The average in the existing relationships with our top tier client and strong product capacity in the industrial fire protection offering. We are in a very competitive position to do more projects.

On April 30, 2008, we announced contract wins for five regional power plants of DaTang International Power Generation, with aggregate contract value of approximately \$4.7 million.

Power plants are also one of our important vertical. China Electricity Council has stated that China's total power generation capacity has exceeded 700 million kilowatt. The United States Energy Department has forecasted that China's total power generation capacity will exceed 800 million kilowatts by the end of 2010 and overtake the US to become number one in the world in 2020. The power industry in China is going to grow significantly over the next three years with the estimate spending of over \$42 billion each year for the next three years for building new power plants and transmission infrastructures. China Fire has observed the significant opportunities in this industry and has a dedicated sales and marketing team to focus on these vertical. As of the end of the first half of 2008, China Fire has won over 20 projects in the power generation industry and we believe this momentum will continue in the second half of the year. The project pipeline that our sales are tracking is over \$30 million in this vertical.

Finally, our expansion strategies. We are very excited about our successful penetration into Nuclear Power Plant sector where we were recently notified that we won the bid for a contract valued at approximately \$7.3 million for Fire Suppression Systems for multiple nuclear power plants to be build by nuclear power group company. We also made preliminary progress in M&A by signing a non-binding memorandum of understanding where China Fire will become a majority shareholder of a fire protection special equipment company. This special equipment company expected to generate more than \$25 million of revenue in 2009.

On the international market front, we recently signed a partnership agreement with an Indian company whose principals have over 25 years experience in India's fire protection industry. The partnership will provide local support to China Fire's EPC fire protection project in India. The partnership will also be responsible for sales in India of China Fire's fire protection product. I will come back on this new initiatives after Robert finishes the details run-down of our financials for second quarter 2008. Now Robert, please.

Robert Yuan

Thank you, Brian. As Brian introduced, our second quarter of 2008 was quite encouraging for China Fire and Security Group. Now, I'd like to share you more with our financial performance for second quarter 2008.

Our total revenue for the second quarter of 2008 was \$16.7 million compared to \$11.5 million, representing 44.2% of revenue year-over-year growth. Revenue in this year, second quarter, was derived from 177 total solution, product sales, and maintenance contract compared to 109 contracts executed for the same period of 2007. Breaking that down, our revenues on total solution increased by 47.2% with \$14.6 million derived from 104 contracts for the second quarter 2008. Our product sales were \$1.5

million derived from 39 contracts in the second quarter of 2008. The revenues from our maintenance service increased by more than 300% or \$0.6 million for second quarter of 2008 compared to \$0.1 million from same period of last year. If we break down our revenue by industry verticals, iron and steel industry is still the main vertical for contributions of our Q2 results, which contributed 83.1% of total. Power generation and the Petrochem contributed approximately 4.9% and 0.2% respectively. Our gross margin for second quarter 2008 worth 61.2% which is higher than the gross margin of 54.6% in the same period 2007. The improvement in our gross margin in the second quarter, was mainly due to two factors. Number one, the execution of contracts for our iron and steel company contribute a higher gross margin during this period. Number 2, the higher percentage of revenue contributions on the sales of our self-manufactures of quality products, including our Linear Heat Detector during this quarter, which brought a gross margin of our product sales up to 85.8%.

In the second quarter 2008, our saving expenses were \$1.7 million as compared to \$1.2 million in the second quarter of 2007, and includes a \$0.5 million or 38.5%. This increase was mainly attributable to the increase of sales force and increased sales initiative compensation. Our general administrative expenses of \$1.1 million as compared to \$1.2 million in the same period of last year.

The decrease of our G&A expenses was due to our better control of our administrative expenses during the period. Our R&D expense in this quarter was \$628,000 or 3.8% of our total revenue, which was used in the improvement of our existing product offerings including Linear Heat Detector and the Water Mist system, and also for the development of new products in the fire extinguishing systems.

Our operating income for the second quarter 2008 amount to \$6.6 million representing a 7.2% increase from \$3.5 million for the same period last year. This improvement was mainly due to the increase of revenue and gross margin during the period. Our total income was \$88,000 for the second quarter 2008 compared to \$718,000 the same period 2007 which include a one-time non-cash gain of \$372,000 due to the change in the fair value of our derivatives instruments. Our provision for income tax was \$11,000 for second quarter 2008 compared to no provision for income tax for the same period last year.

Starting in the year 2008, our two subsidiaries, Sureland equipment and Tianxiao equipments are subject to income tax charge rate of 12.5% and 25% respectively for second quarter of 2008. Of two of our subsidiary, Sureland Industrial and Beijing Hua An are still enjoying tax exemptions in year 2008. In the beginning of 2009, Sureland Industrial, which is our main operating subsidiary, will be subject to income tax charge rate of 12.5% for the next three years.

Our GAAP net income for the second quarter of 2008 was \$6.7 million as compared to \$4.2 million for the same period 2007. This represents an increase of \$2.4 million or 57.4%. On the non-GAAP basis, our net income increase 72.5% from 3.9 million for same period 2007, which excluded a one-time non-cash gain of \$0.4 million for the changes in fair value of derivatives.

Our comprehensive income for second quarter 2008 which has a currency adjustment of \$1.3 million, while net income was \$8 million as compared to \$4.8 million

comprehensive income for the same period of 2007. This represent an increase of 57.5%. Our fully diluted GAAP EPS was \$0.24 for second quarter 2008, compared to \$0.16 for the same period 2007. Fully diluted share outstanding in the second quarter of 2008 amounted to \$28.2 million.

Now I would like to briefly cover some highlights on our balance sheet and cash flow statement. After June 30, 2008, we have working capital of \$54.1 million including cash and cash equivalent of \$20.5 million. Our base outstanding or BSOs were 108 days for the second quarter 2008 compared to 122 days for the same period of last year. After June 30, 2008, our total liability is around \$31.6 million and our shareholders equity was approximately \$55.0 million, improved from \$50.2 million in the beginning 2008, only we have no debt on our balance sheet.

In terms of cash flow, our net cash provided by operating activities during the second quarter 2008 was \$5.2 million, compared to \$0.2 million net cash in the same period 2007. At the end of the second half 2008, value of contract that we have signed but not executed or our backlog value amount to \$71 million compared to \$62 million I think in the 2007. Out of this \$71 million backlog, 80% is from a contract in iron and steel industry. The \$71 million backlog has now include the \$4.7 million contracts from Xinyu Iron and Steel Company that we announced yesterday and does not include the \$7.3 million nuclear project where we'll receive the bidding – the winning notification either.

The growth of our backlog within this period is due to the strong momentum that we build at signing contracts in the first half of the year 2008. And it brings us higher degree of confidence in our forecast for the second half of the year 2008. Now, I would like to turn the call back to Brian. Brian, please.

Brian Lin

Thank you, Robert. As Robert claims, we are excited with our results in the second quarter of 2008. The outlook for our business going forward remains very strong as we continue to benefit from the industrialization and urbanization in China.

Now, I want to update our shareholders the progress we have made so far on executing our growth strategies. As part of the growth strategies, we stated that we will grow of our business organically in our core industries, including iron steel, power plants and petrochemical plants. Our strong reported financials and the contract wins and the increase backlog demonstrate that we have executed well on our organic growth.

Our growth strategy also stated that we will expand into new industrial sectors that we've setup a dedicated team for this initiative and started the preparation and bidding for projects in nuclear power plants, highway tunnels, and subways. We were recently excited upon being notified that we won the bid for a contract value of approximately \$7.3 million for fire suppression systems in multiple nuclear power plants to be built by a nuclear power crude [ph] company. We have completed all the technical and commercial negotiations with the customer and expected the contract will be signed over the next few weeks. We will disclose more details then. In addition to this bid, we are also in the process of bidding for a few more prop jets in nuclear power plant sector, including fire alarms systems and suppression systems.

China is going to build between three to five nuclear power plants each year until 2020. Each nuclear power plant cause about \$7 billion. The government also mandate that at least 50% of the equipment used for the new nuclear power plants will be sourced locally. News from World Nuclear Organization has shown that China has 11 nuclear power reactors in commercial operations, six under constructions, and several more are about to start construction. We are also actively participating in the fuel bids in the transportation industry as well.

China Fire expects to grow through merger and acquisitions. We recently signed a Memorandum of Understanding where China Fire will become a majority shareholder of the Fire Protection and Suppression Equipment Company. China Fire will invest cash as working capital for the existing business to support its growth. This special equipment company had approximately \$40 million of revenue for 2007, and expected to generate more than \$25 million in revenue in 2009. China Fire expects to complete the transaction after final negotiations with the current business owner and after we complete our due diligence. But we advised our investors and analyst not to count on the revenue from this company until we have finalized and complete the transaction because there's no binding obligations yet. We're also in discussion with a few total solution providers who have their own unique customer bases. China Fire believes that these companies are strategic fit and China Fire will not only consolidate the revenues and profits generated by these companies but we also benefit by selling the product manufactured by China Fire to this company. The bottom line for our M&A is that all transactions should be encrypted [ph].

China fire has firmed up it's strategy, expanding into India by protection market. One of the key international market of China Fire. I made a trip to India last month, and then we started about the fire protection business potentials there, especially in the power plant sector. There will be significant growth in spending on the infrastructure build out including power plant, airport, transportation, iron steel, etc. We believe this trend will continue over the next decade. We have signed a partnership agreement with a company in India whose principals have over 25 years experience in India's fire protection industry. And this partnership will be converted into a joint venture when approved by the Board of Director's of China Fire. This joint venture will provide local support to China Fire's EPC fire protection projects in India. EPC stands for Engineering, Procurement, and Construction which existentially like the total solution projects in China, where China Fire has tremendous experience and expertise. The initial feedback from some potential customers in India is very positive for these kind of commercial arrangements. The joint venture will also be responsible for sales in India of China Fire's fire protection product including our UL-listed Linear Heat Detector, our Flame and Gas Detectors, and our Fire Suppression Systems.

China Fire is still in the early stage of executing its growth strategies. We are confident about our organic growth over the next few years but we aspire to grow faster by becoming a consolidator in China's fire protection industry. With this strategy, China Fire will extend its addressable market from pure industrial fire protection product and systems to the entire fire protection market where we will be the leader in each sub-sector that we focus on. China Fire will also expand its

addressable market from domestic China to international markets where market and potential growth for our product and services is strong.

Between now and our next conference call for the third quarter 2008, China Fire is going to participate in the 12th International Fire Protection Equipment, Technology Conference and Exposition held by China Fire Protection Association from October 28 to the 31st, 2008 in Beijing. The conference is held every two years and is the most authoritative International Fire Exposition held in China. It is approved by the Ministry of Public Security and Ministry of Science and Technology of China. It will attract a large number of visitors from more than 60 countries and regions, many of those from the pertinent [ph] Department of Fire Bureau, fire institute, manufacturers, customers, and design institutes all over the world. We are actively preparing for the exposition and we believe that is a great platform for us to demonstrate our advanced products and services, as well as our positions – positioning our brand name in the international market. We sincerely welcome our share holders and potential share holders, our analysts who comes to the conference and to visit our facilities in Beijing and Xinjing [ph] as well.

Before we complete this conference call, I would like to provide a revised guidance for the year 2008. As Robert stated before, we have a very strong backlog of \$71 million in the first half of 2008. We also have a strong pipeline of projects that our sales are actively tracking. We're very pleased to announce that we will raise our financial guidance for the year 2008 as follows – revenue, to be at least \$68 million from the previously \$66.6 million; GAAP net income, at least \$24 million from the previous \$22.3 million; fully diluted EPS, at least \$0.84 from the previously \$0.78.

Again, we're very pleased with our growth trajectory and plan to continue to generate strong growth in our business across all our operating segments. I would like to thank you all again for participating in our conference call, and your support of China Fire.

I will now turn the call over for questions. Operator please.

Question-and-Answer Session

Operator

(Operator instructions) The first question comes from Chenyi Lu of Brean Murray. Please go ahead.

Chenyi Lu – Brean Murray, Carret & Co.

Hi. Very good quarters, congratulations. I just a two or three questions I like to ask. First question regarding your gross margin. This quarter the gross margin is 61.2%, which is I believe it's the highest over the last 8 or 9 quarters. So, my question to you is what do you expect the gross margin going forward over the next 6 to 12 months?

Brian Lin

As we have introduced, this quarter's gross margin, 51.2%, is actually definitely above the guided gross margin, which is 50 to 55% of our – in our regular time. A high gross margin this quarter is mainly due to this exclusion of a contract which tend to be actually a higher gross margin during this period and also for the higher percentage of sales of our propriety products. So, I believe in the long run, up in the full year, I think our gross margin guided a range that's due in the 50 to 55%. But, based on the backlog we have, currently, which will be recognize for doing the first and the second

half of the year. I think we will have a higher level of gross margin in the second half of the year of 2008.

Chenyi Lu – Brean Murray, Carret & Co.

Okay. Great, thank you. My second question regarding your backlog, which is also very strong, \$71 million by versus the one you have by the end of 2007, \$62 million. So, my question here is among these backlog to use and how long it would take this backlog to recognize as revenue? Every 12 months or 6 months or can you just comment on that?

Brian Lin

Yes. Actually it depends on the contract in our backlog but I think it's in the range of 6 months to 12 months around that, the duration of the contract.

Chenyi Lu – Brean Murray, Carret & Co

Okay. So, if I have to assume, can I associate it –

Robert Yuan

Certain projects take longer and certain projects take shorter, so it's really hard to say that percentage.

Chenyi Lu – Brean Murray, Carret & Co

Okay, great. Thank you. My third question regarding your international expansion, I know, you just signed the partnership contract – partnership with Indian distributor. So my question to you is, what do you see the international revenue in 2009 – 2010?

Brian Lin

For that, I think, the market is very good in India. We see a lot of projects open for bid right now, but honestly, we do not have a solid plan yet. We will provide those numbers appropriately when we have all these joint ventures set up and everything finalized, then we'll provide guidance that's appropriate.

Chenyi Lu – Brean Murray, Carret & Co

Great. Thank you, a very good quarter.

Brian Lin

Thank you.

Robert Yuan

Thank you.

Operator

The next question comes from Michael Cox of Piper Jaffray. Please go ahead.

Michael Cox – Piper Jaffray & Co.

Good evening, gentlemen and congratulations. My first question is on just the general market environment. I'm curious if your seeing any delays in projects. Is there in China owing to this tighter lending markets, etc. that have been put into place?

Brian Lin

The overall Chinese economy is going down a little bit but from our sales profit perspective, this normally takes about a year, sometimes two years, to sign a contract especially for larger contract. There's a long lead time and long preparation time, so the – from that perspective, the slight delay is not impacting us now but going forward, we think in the iron and steel industrial sectors and the infrastructure, we are still very confident that the projects we are tracking, the volume is very significant and even

though there might be some delays in certain projects but from the overall perspective, we don't see any impact in our business.

Michael Cox – Piper Jaffray & Co.

Okay. That's helpful. Are we still being provided with an update on the large iron steel project bids that you have outstanding that were discussed on the last quarter's call, I think they're in the \$20 million range, I think the end that there were two of them that you had outlined last quarter that would be coming up for bid by the end of the year. Any updates you can provide there?

Robert Yuan

Yes. We mentioned there are two large projects, one is in Tianjin and the other is in Guangxi, Huangchenggang. This is going to be built by Wuhan Iron Steel, which is a long-term customer of us. The message we are hearing is still – the project is still on track and we expect that the project will be open up for bid towards the end of the year.

Michael Cox – Piper Jaffray & Co.

Okay, thank you. And then I was hoping you could provide some additional detail on your planned acquisition. Any detail around the type of products, the level of ownership you plan to take and, if you can, the margins of that company compared to yours?

Robert Yuan

Actually, merger and acquisition, I think we own at least 51% the majority ownership of the company, and the gross margins and the type of the equipment, we are not allowed to disclose at this time until we finished all the transactions. Sometimes the messages can be – if it's not done, it's not appropriate to make a lot of detailed descriptions on these transactions. We would like to make sure we get everything completed and we provide details then.

Michael Cox – Piper Jaffray & Co.

Okay, that's fair. And my last question is on maintenance service sales, have been running in the \$500,000 to \$600,000 range here for the first two quarters of 2008. Do you expect that to be a reasonable range going-forward?

Robert Yuan

I think yes. The growth of our maintenance service is basically due to this broader customer basis we have built out in the non-steel industry, and but the – right now the maintenance service, you can actually gather the gross margin from these numbers disclosures. If to rank it lower than company average, the main reason is the maintenance service is doing out the main business. Currently the purpose of our maintenance service is to maintain a good customer relationship. So, if we provide them a very good maintenance so we expect in the future we can gather more repeat business from our clients. So I believe that this – with a broader customer basis, and also with a more systems, all the systems into the market, the growth of our maintenance service will be factored on a company's average.

Michael Cox – Piper Jaffray & Co.

And thank you very much.

Operator

Before continuing, Mr. Yuan and Mr. Lin, we received a request, if you could kindly speak more directly into the speakerphone so that you can be heard more clearly, kindly. Thank you. Our next question comes from Adele Mao of Susquehanna International Group. Please go ahead.

Adele Mao – SIG Susquehanna Financial Group

Hi. I have several questions. First of all, I like to get a little more details on the guidance and backlog. Could you just walk us through how you reach your \$68 million revenue guidance? Specifically, how much of the \$71 million backlog will be booked – do you expect to book in 2008 and how much new contracts from the second half have you factored into the guidance?

Brian Lin

Adele, the –we do not have all these detailed information, like how we come up from the backlog \$62 million in beginning of the year to \$71 million at the end of the first half. We only disclose those contracts which are above US\$3 million and go perhaps a single customer. But we are – in between, we signed many smaller contracts which we do not disclose and no more disclosure policy is actually once a year. But I think, this time of the year, we like to give our shareholders more visibility in our business, that's why we decided to disclose the number. And bear in mind that these numbers do not include the newly announced contracts. These are all of first half of the 2008.

Adele Mao – SIG Susquehanna Financial Group

Okay, that's fair. Let me just ask you about the profits. If you could just speak to the progress related to Capital Steel. And when do you – I think, in the past you mentioned that we would expect the first phase to be completed sometime later this year. Are we still on track for that? And also, when do you expect the second phase bids to be finalized?

Robert Yuan

The Capital Steel company is going to be operational at the end of October, and that's still their plan. But the operational doesn't mean the full operation of the entire 10 million tons of production. It may be between 5 million to 6 million tons of output will be operational at times. I think all the projects are following very closely by protection systems deployment is running closely into a wall build up. We are recording revenues accordingly.

Adele Mao – SIG Susquehanna Financial Group

And do you expect the second phase to be –

Robert Yuan

I think as far as – Adel you also ask whats the second phase? The second phase, we do not know at this point, and we will probably know more details towards the end of the year, and what the plan is for the phase 2 project. There will be a lead time before the project has started.

Adele Mao – SIG Susquehanna Financial Group

Okay. That's helpful. You mentioned that 80% of your reported backlog comes from contracts from iron and steel industry. In the past, I think about, at least at the end of 2007, that was half of the backlog from Capital Steel. Could you just update us with sort of customer concentration in iron and steel industry?

Robert Yuan

Alright. Actually we don't disclose to bring down our backlog, I think also, this is to our computation purpose, so we don't name out these which company is in our the backlog value. So, we only give you aggregate value from iron and steel industry. So, 20 other percent is from the other verticals, including the power generation and the petrochem. Now there are new verticals.

Adele Mao – SIG Susquehanna Financial Group

Okay, that's fair. It seems that – as you mentioned before, the gross margin this quarter is more – seems to be more project specific. As the iron and steel customers contributed to your higher gross margin this quarter, I was wondering if this – do you guys generate better margins in iron and steel industry in general versus the other verticals that you are breaking into, such as nuclear power plant?

Robert Yuan

Actually, for the – our gross margin for the iron and steel will definitely bring us a higher gross margins. The main reason is our proprietary products actually had pretty used into the iron and steel industry. But for the other verticals, maybe we have to purchase some third party products and resell it. So, the margin – the gross margin for the other industry will be lower than the iron and steel industry.

Adele Mao – SIG Susquehanna Financial Group

I see, okay. That's helpful, thank you.

Robert Yuan

Thanks.

Operator

The next question comes from the John Ma of Roth Capital Partners. Please go ahead.

John Ma – Roth Capital Partners

Congratulations, Brian and Robert, very strong quarter.

Robert Yuan

Thank you.

John Ma – Roth Capital Partners

I have a couple of questions. Number one, you mentioned for the \$7.3 million contract signed for – with the nuclear power plant, how long – over what computer [ph] can we expect the revenue be recognized?

Robert Yuan

At this point, we do not have the detailed information on that. We will make a formal announcement when we have the contract signed. All the details will be provided.

John Ma – Roth Capital Partners

Okay. And also, notice the contract you signed, you announced yesterday, Xinyu Iron Steel Company. My question, number one, is this your new client Or it's your repeat customer?

Brian Lin

This is a new client. We have sold very small product to them before at the beginning of the year, but we have never done any business with them prior to 2008. This is one of the major – they just started a major expansion and it was disclosed in our conference call last time we have fall-in quite a few larger projects and this is one of

them. The others we're still following.

John Ma – Roth Capital Partners

And based on your press release you said this is the 23rd of August, steel company in China. My impression, your –firm normally, in the past dealing with audit, in the top 10 – top 20 company, is that sort of tin strategy or go deeper even with smaller iron steel company?

Brian Lin

We are really looking it from the planning – from the government planning perspective when they have approvals for certain state – large state owned companies to grow, to expand, then we follow in that project. So based on their track records, yes, we have been following this large company, seeming it's not the huge company but it's still 150 – 50 million tons of output is not small either. So, but our strategy it happens to be we're following the state policies they are the funding, where the funding goes, where the full growth of expansion go.

John Ma – Roth Capital Partners

My last question is on tunnel. In the past, I know you spent some effort on the tunnel. Can you give us some progress how you do on the tunnel project?

Brian Lin

We have biddings on a few tunnel projects but there's no results are – been declared yet. So, we can not provide any information but we are bidding on a few. So, we'll provide detailed information when that becomes available.

John Ma – Roth Capital Partners

Okay. Thanks so much.

Operator

Currently, the last question comes from Edward Hemmelgarn of Shaker Investments. Please go ahead.

Edward Hemmelgarn – Shaker Investments

Yeah. Thanks, Brian. Congratulations on another good quarter. Just your R&D expenses kind of fluctuate a lot. Is there – from quarter to quarter – what causes that so much?

Robert Yuan

We do have a fixed R&D budget. What we plan is we have a few new initiatives in product development, specially in fire suppression sector. So when we have requirements, then we have to purchase, we have the idea then we have to do prototyping then we have to buy some machineries to test the new products and then so, in certain quarter we incur some expenses in that but in other quarters we may not. So, it's still a small percentage of revenue overall.

Edward Hemmelgarn – Shaker Investments

Oh, it is. I was just – more from a observation standpoint. That explanations' fine. The other thing, do you anticipate any, maybe a slowdown in, or maybe not a slowdown, results in Q3 relative to Q4 just because of everyone's focus on the Olympics.

Robert Yuan

This time, we do not see the impact yet, since our business, most of the revenue are recognized on the percentage of completion basis, we don't see those impacts yet. And

also, the pipelines we have under the sales contract – the sales lead that we are tracking which don't really, I think, give us any impression that we're going to slow down any time soon. But we're still very optimistic, even though the overall environment in China especially in the commercial, in the retail sector, and the currency, the Chinese RMB has been appreciations, overall environment is not as good as last year but from our industrial and nuclear our protection sector as you relate to the infrastructure, I think we are okay.

Edward Hemmelgarn – Shaker Investments

Okay. Thanks.

Robert Yuan

Thank you Ed.

Operator

Mr. Yuan and Mr. Lin, there are no other questions at this time. At your request, I will now conclude today's conference. This now concludes – thank you. This now concludes the China Fire 2008 second quarter results earnings call. You may now disconnect your lines.

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