

FINAL TRANSCRIPT

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GRRF - Q2 2009 CHINA GRENTech CORP LTD Earnings Conference Call

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CORPORATE PARTICIPANTS

Qingchang Liu

China Grentech Corp. Ltd. - Vice-President - Corporate Finance

Rong Yu

China Grentech Corp. Ltd. - Director, CFO

Ying Liu

China Grentech Corp. Ltd. - Deputy General Manager - Wireless Coverage

CONFERENCE CALL PARTICIPANTS

Adele Mao

Susquehanna International - Analyst

John Charles

Piper Jaffray - Analyst

Lisa Soh

Macquarie - Analyst

PRESENTATION

Operator

Welcome to China Grentech 2009 second quarter results conference call. Statements made in the conference call regarding certain anticipated business prospects constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and as defined in Private Securities Litigation Reform Act of 1995.

These statements are based upon Grentech management's current expectations. And actual results could differ materially. Information regarding factors that could cause actual results to vary can be found in the Company's filings with the Securities and Exchange Commission at www.sec.gov. The Company undertakes no obligation to update or revise forward-looking statements to reflect subsequent events or changed assumptions or circumstances. Following management's opening comments, you will have the opportunity to ask questions. I would now like to turn the call over the Company. Please go ahead.

Unidentified Company Representative

Thank you, operator. And thanks, everyone, for joining us for our second quarter 2009 results conference call. Joining me today are Rong Yu, Chief Financial Officer, Ying Liu, Deputy General Manager of Wireless Coverage, Qi Wang, Vice President of RF Business, and Qingchang Liu, Vice President of Corporate Finance.

As we'll proceed through our remarks, we will refer to our results presentation, which can be downloaded from our website at www.grentech.com.cn in the investors section under financials. After the overview of our strategy on slide four, the slide pertaining to our second quarter 2009 performance starts on slide six.

On slide 6, we've included for your reference two charts showing our current and past top line performance. Looking at the chart on the right, you can see that our second quarter 2009 revenue grew by 127% over the same period last year, while the chart on the left shows that we're building a track record of steady growth year over year. And our total revenue in the first quarter of 2009 has already exceeded RMB708 million, which is more than 70% of what we have recorded for the full year 2008.



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Despite the completion of 3G network construction in China's major cities, 3G network coverage has not been completely finished, though demand from the three telecommunications operators remains strong. China Unicom in particular has set a more robust pace than other operators. Based on our leading market position, nationwide integration services team, and well-established relationships with these operators, we were able to capture growth opportunities and reported the strongest second quarter in our history from a revenue perspective.

Now let's take a look at our wireless coverage business highlights on slide 7. The chart on the right shows that our wireless coverage revenue for the second quarter 2009 increased by 116.7% to around RMB340 million. Again, a key growth driver here was the strong demand from all three telecommunications operators to upgrade their existing wireless coverage systems in order to simultaneously support both 3G and 2G networks.

Revenue from China Unicom increased by RMB130 million or about 325%. And revenue from China Mobile and China Telecom increased by about RMB16 million and RMB48 million, respectively. In the second quarter 2009, nearly a half of our wireless coverage revenue came from China Unicom, while around 32% and 16% was from China Mobile and China Telecom, respectively.

Moving to our base station RF product business highlights on slide 8, revenues on base station RF products increased by around 183% year over year to about RMB83 million, mainly due to 3G network construction in China. Due to a relatively flat market demand for base stations in the second quarter 2009 as compared to the peak season in the first quarter 2009, our revenue from RF products was weaker than the first quarter 2009 as we have anticipated.

Next, let's take a look at slide 9. Both operating income and net income have returned to positive this quarter and as a result of substantial revenue increase and tighter cost control measures, which reduce operating expenses as a percentage of total revenue to 18% this quarter from 36% in the second quarter of 2008.

As we continue to execute the key business initiatives announced earlier to streamline our cost base and operations, our commitment to improving operating efficiency and tighten cost controls together with our focused strategy to drive revenue growth has delivered another quarter of strong bottom line results.

Now let's go for the financials, beginning with income statement on slide 11. Benefiting from the telecommunications operators' continued imperative to improve their network coverage systems, our revenue in the second quarter of 2009 increased 127.1% year over year to RMB423.2 million. This is a significant revenue increase.

Our gross profit increased 70% year over year to RMB105.9 million. The gross profit increase was partially offset by the decreased average selling price of wireless coverage equipment in this quarter. And as a result, our gross margin decreased to 25% in the second quarter 2009 from 33.3% in the same period last year. The gross margin was also impacted by the increasing revenue contribution from base station RF products, which have a lower gross margin.

Our operating income in the second quarter 2009 was RMB29.6 million as compared to an operating loss of RMB4.9 million in the second quarter 2008. Net income for the second quarter 2009 was RMB13.3 million as compared to a net loss of RMB17 million in the second quarter 2008.

Now turning to our balance sheet on slide 12, cash, cash equivalents, and pledged time deposits decreased 20%. This was mainly due to working capital outflow for raw material purchases to meet increased sales demand and operating overhead. Because the majority of sales generated in the second quarter 2009 have not yet entered into the collection period, total accounts receivable increased by 18.6% to about RMB1.5 billion. However, we have increased collections of each account receivable by RMB280 million during the first half of 2009 as compared to the first half of 2008 with most of the collections coming from contracts booked in 2008 and earlier.



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There are three factors that helped to speed up collections during the past quarter. One is the management's initiatives to improve collection of each account receivable. And the second is the increased revenue contribution from RF products, which have a shorter collection period. And the third factor is the improved payment terms for our wireless coverage equipment.

In addition to our continued stringent efforts in the collection of accounts receivable, we have more than RMB500 million available in bank credit facilities as we believe the payments collected and the credit facilities will provide sufficient working capital to support our 2009 operations.

Inventory increased by 57% to RMB817.3 million, mainly due to increased raw material purchases to meet sales orders and higher level of finished goods that have been installed but have not yet been recognized as revenue.

Total assets increased by 17.4% to around RMB3.3 billion as of June 30, 2009, mainly due to increases in inventory and total accounts receivable. Total liabilities increased by 34.2% to around RMB1.9 billion, primarily due to an increase of RMB397.5 million in accounts payable for the purchase of raw materials and an increase of RMB80.7 million in short-term bank loans.

Moving to our business outlook on slide 14, in terms of wireless coverage business, we expect the third quarter 2009 revenue to increase significantly over the same period last year. Although 3G network construction projects have been substantially completed in China's major cities, network coverage quality remains the key issue for the operators as they endeavor to commercialize their 3G business, as we believe the demand from the three telecommunications operators will remain strong in the third quarter 2009 as they continue to build wireless coverage systems.

Grentech placed in the top three position in the recent China Telecom centralized equipment bid. And according to the tender rules, China Telecom will divide 70% of the total equipment order among the top three companies. Together with our leading market share in China Unicom and China Mobile's coverage equipment procurement programs, we're confident that we're in the best position to capture the growing demand from the telecommunications operators.

In addition, we have established a nationwide integration services network with one of the largest and most experienced project services teams in China. We believe this will further strengthen our competitiveness in the market.

In terms of base station RF products, we expect demand for base station RF models in the third quarter 2009 to increase significantly over the same period last year. During the recent procurement bids for the second half of 2009, we obtained a larger share of contract value from the two largest domestic base station manufacturers. And we continue to be one of the key suppliers of CDMA and WCDMA base station RF modules for them as well.

With the commencement of TD Phase III network construction, we also began bulk supply of RRU products to the other two domestic base station manufacturers, as we believe we will benefit from the significant increase in demand from the largest base station manufacturer in the coming quarters.

Finally, I'll turn to our guidance for the third quarter of 2009 on slide 15. We estimate that revenue for the third quarter of 2009 will range between RMB380 million and RMB420 million, representing a year-over-year increase of 78.8% to 97.7%. And now with that, we'd like to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)



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And your first question comes from the line of Adele Mao with Susquehanna International. Please proceed.

Adele Mao - *Susquehanna International* - Analyst

Thanks. It's Adele Mao from Susquehanna. I have several questions. First one is related to revenue guidance. You guided 3Q revenue RMB380 million to RMB420 million. Given your typical seasonality, it looks like in the past 3Q should be slightly better than the second quarter. But your revenue guidance seems to be flat quarter over quarter. I was wondering what are the variables that could swing your revenue in the third quarter now that we're already halfway there. And if you could also comment on the mix of wireless coverage and RF in the third quarter, that would be very helpful.

(spoken in foreign language)

Unidentified Company Representative

And Mr. Liu will answer your first question.

Qingchang Liu - *China Grentech Corp. Ltd.* - Vice-President - Corporate Finance

(interpreted) The main reason for the flat guidance in Q3 versus Q2 is -- we'll first talk about wireless coverage. The wireless coverage revenue in Q3 -- wireless coverage revenue in Q2 already increased substantially. And that basically met our production capacity there. So in Q3, the demand still stays very strong at the same level. So the revenue will come out about the same, flat to Q2.

In terms of variables for wireless coverage business, we don't see any at this point. Because we still see the operators' demand for wireless coverage remains very strong basically because two reasons. The first reason is for the TD construction, it'll be extended to 200 cities in the second half of 2009 as WCDMA will cover 268 cities. And for CDMA, it'll be built in 300 cities.

And this will create a strong demand for the indoor coverage. And for the main -- the key cities in China that has already come -- almost completed 3G infrastructure network, the indoor coverage is still less than 50% of buildings in those cities. So we still see a strong demand to -- for the upgrade the indoor coverage there.

In terms of RF business, we also think the Q3 revenue will be relatively flat compared to Q2, mainly because the contract bids for TD construction did not come out until end of July -- actually this July 31st. And the supply of TD network products did not start until August. So that had somewhat impacted our RF revenue in Q3.

Other reason also due to the contact bids for the two largest base station manufacturers have just recently completed. And we have achieved pretty good results there. So based on the foregoing, we don't think in Q3 there will be a peak season there. So we guided Q3 revenue to be flat compared to Q2. Does that answer all your questions, Adele?

Adele Mao - *Susquehanna International* - Analyst

Yes, I certainly believe so. Thank you very much for the details. Just related to that, I would like to move onto my second question, which is regarding gross margin and how it's driven by the revenue mix. Just looking at the first quarter, you had a very different revenue mix from wireless coverage versus RF. Although wireless coverage accounted for a larger portion of the revenue mix in the second quarter, gross margin is still somewhere around 25%. What is sort of the gross margin for wireless coverage in the quarter? And what is for RF? And do you see any further margin pressure in the coming quarters and your overall gross margin expectation going forward?



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Qingchang Liu - *China Grentech Corp. Ltd. - Vice-President - Corporate Finance*

(interpreted) Okay. For Q2, our revenue, around 80.4% came from wireless coverage business. And about 19% came from RF business. And our overall gross profit margin was at 25%. If you breakdown by wireless coverage and RF for wireless coverage in the second quarter, the gross margin was at 26.7%. And for RF business, it was at 18.1%. Our gross margin's relatively lower for this quarter. One of the reasons is because the product mix within the wireless coverage business -- during the second quarter, our revenue from equipment sales was around 70% of total wireless coverage revenue. And the integration service was only 30% of the total wireless coverage revenue.

Moving into second half of 2009, revenue from our integration service will definitely increase because we have large portion of finished installed goods but not entered past the inspections there. So the full year 2009, we're looking at around 60% wireless coverage revenue from equipment sales. And 40% will come from integration service.

So for the -- because the different product mix I just mentioned, the full year 2009 margin, there are definitely room for improvement there plus for RF business the margin is basically stable -- can be stable at Q2 level. So for the full year 2009 gross margin, we're pretty much confident that we're on track to achieve our previous guided percentage.

Adele Mao - *Susquehanna International - Analyst*

Okay. Thank you. You discussed a few catalysts into the second half of this year. Could you also comment on the overall progress of China's 3G telecom infrastructure build-out plan and how you see that into 2010 going forward and how you sort of see the infrastructure spending trend into the next couple years?

Qingchang Liu - *China Grentech Corp. Ltd. - Vice-President - Corporate Finance*

(interpreted) Okay. For the network construction, basically '09 is a peak time. For example, take China Mobile, for example. The TD construction, their target is to complete that in 200 cities in 2009. And I think the 2011 target is different coverage in all the major cities -- all the cities in China. And in terms of -- investment there is around RMB58.8 billion already.

And going into the 2010 and 2011, the CapEx is set to be a bit lower compared to 2009. And for 2009, I think the total CapEx investment was RMB133.9 billion. And for 2010, it's estimated to be RMB131 billion. And for 2011, it's around RMB110.5 billion there. In terms of investment in wireless coverage, we expect they'll continue to increase, to grow there.

We have a report from Bayes. It says that the demand for the wireless coverage there for 2009 is around RMB13.8 billion. Going into 2010, it will reach RMB17.2 billion. And going into 2011, it's going to reach RMB20.3 billion there. So we definitely see a continued demand for wireless coverage.

And the numbers we just mentioned from Bayes are the combined investment from all three telecommunications operators in the wireless coverage section. Now let's take a look at China Unicom. Their target is to build their WCDMA network in 284 cities in 2009.

For Unicom for 2009 to '10, I think their investment is about RMB100 billion there. And for 2009, in terms of their investment in 3G networks is around RMB38.7 billion. For 2G networks, their investment is around RMB23.7 billion. From that, we can see that going into 2010, China Unicom will still have around RMB50 billion investment in wireless coverage.

For China Telecom, the CapEx, their CapEx is relatively smaller. For the '09 and -- 2009 and 2010 plan, their CapEx is around RMB80 billion. Overall, the CapEx from the three telecommunication operators will decrease. However, the investment in wireless coverage will continue to increase.

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Unidentified Company Representative

That concludes our answer, Adele.

Adele Mao - *Susquehanna International - Analyst*

Okay. My last question is about your share buyback program that you announced some time ago. When did you start? Or if you have started, how many shares have you bought back in the past several weeks or so?

Qingchang Liu - *China Greentech Corp. Ltd. - Vice-President - Corporate Finance*

(interpreted) Our share repurchase program started from September 2007. Our Board of Directors has approved and allowed our management to continue purchase according to the market conditions. As of June 30, 2009, we have repurchased a total of 1.31 million shares. We'll continue to manage our market condition and make the best decisions in order to maximize our shareholder value.

Adele Mao - *Susquehanna International - Analyst*

Okay. I appreciate the details. Thanks very much.

Unidentified Company Representative

Thank you, Adele.

Operator

Your next question comes from the line of John Charles with Piper Jaffray. Please proceed.

John Charles - *Piper Jaffray - Analyst*

Hi. Thanks for taking my questions. Can you hear me?

Qingchang Liu - *China Greentech Corp. Ltd. - Vice-President - Corporate Finance*

Yes.

Unidentified Company Representative

Yes.

John Charles - *Piper Jaffray - Analyst*

I guess the first question is -- and congratulations on the really good results, firstly. Just if we can switch maybe to the operating expense line item, if you could maybe explain how much of the operating income and the margin improvement was from the

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higher sales and how much from just cost control internally within the Company and how we should think of these costs into the second half of the year.

Do you have even more potential for headcount reduction or any other costs? So maybe if you could walk us through what the second half of the year is going to look like in terms of cost cutting and operating margins if these levels can be sustained in the back half of the year. Thank you.

Unidentified Company Representative

(interpreted) In 2009, the management has put in great effort to increase operating efficiency. We hope over a year of hard work we'll see obvious improvement in this form.

Okay. In terms of G&A cost, G&A expenses, in 2008, excluding the extraordinary items, it was around 6.9% of total revenue. Our target for 2009 is 5% to 6% of total revenue. In terms of sales and distribution expenses, '08 -- for 2008, it was 14.1% of total revenue. And our target for 2009 is 10% to 11%.

In terms of R&D expenses, for 2008, it was 7.1% of total revenue. For 2009, our target is 4% to 5%. However, we will continue to invest in developing new products in areas such as W-LAN and digital repeaters. One point to mention, like we just said, although we want to control the R&D expenses, we will continue to spend in developing the important and key new products.

John Charles - Piper Jaffray - Analyst

Thanks for that. And so I guess the question I have is in terms of just looking at the longer-term model, is this mid-single digit? So based on the guidance you've given, I think we get to about mid-single digit for the operating margins overall. Is that the upper threshold for the Company? Or can we expect something -- can we expect double-digit operating margins at some point as you all gain efficiencies and as you all start continuing the 3G build into 2010? Or is a 9%, 10% gross margin, is that going to be upper threshold in terms of how we should think about Grentech?

Unidentified Company Representative

(interpreted) 2009 operating margin is definitely -- I think you see a big improvement when compared to 2008, where it was I believe around 1%. For 2009, however, it's still in the single digits. But going into 2010, we definitely expect to see continued improvement.

Qingchang Liu - China Grentech Corp. Ltd. - Vice-President - Corporate Finance

(spoken in foreign language)

Unidentified Company Representative

Mr. Liu just added to the answer. He said for Q2 2009, the operating margin was around 7%. In terms of full year 2009, it should be slightly better than this.

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John Charles - Piper Jaffray - Analyst

Okay. Great. And if you could just maybe walk us through what your expectations are for cash and what options you all have in case you all need slightly more working capital. Given the current cash situation, are you all talking with people in terms of the potential for raising some more capital? And what options do you have at this stage?

Qingchang Liu - China Grentech Corp. Ltd. - Vice-President - Corporate Finance

(spoken in foreign language)

Unidentified Company Representative

Mr. Liu answered your question. The cash we have on hand plus the bank credit facilities and available facility amount, we believe we have sufficient working capital for our growth in 2009.

Qingchang Liu - China Grentech Corp. Ltd. - Vice-President - Corporate Finance

(interpreted) According to our estimated growth for this year, our working capital requirement, it's around RMB430 million. Amount of the RMB430 million, half of it basically can be taken care of by our accounts payable credit with our suppliers.

Actually, our need for bank facilities is only around RMB200 million. Currently, we have available bank credit facilities around RMB600 million. .

John Charles - Piper Jaffray - Analyst

One quick clarification -- the RMB430 million for working capital, you said that was for what time period?

Qingchang Liu - China Grentech Corp. Ltd. - Vice-President - Corporate Finance

(interpreted) So the RMB430 million working capital is for -- that's the amount we will need for full year 2009 during the very peak. Okay. Just to clarify my answer earlier, for 2009, the total working capital need is RMB1.5 billion. The RMB430 million is the additional that we will --

In the beginning of the 2009, we already have RMB1 billion in working capital. And according to our forecast for the whole year growth, our needs for working capital is RMB1.3 billion in total. Okay. So that means we need to raise additional RMB430 million in working capital, which can be obtained from two different channels. One is through account payable. And the other is through banking credit facility.

John Charles - Piper Jaffray - Analyst

Okay. Perfect. Thank you so much for that. And the final question from me -- interest income and interest expense, can you help us think about how we should model that for the back half?

Unidentified Company Representative

I'm sorry, John. Is it interest income and interest expenses?



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John Charles - Piper Jaffray - Analyst

Yes.

Rong Yu - China Greentech Corp. Ltd. - Director, CFO

(interpreted) Okay. For the first half, the total interest expense is around RMB27 million. And for the full year target, we want to control that to within RMB60 million.

John Charles - Piper Jaffray - Analyst

You said RMB50 million?

Unidentified Company Representative

RMB60 million.

John Charles - Piper Jaffray - Analyst

And how about interest income?

Unidentified Company Representative

John, the number Ms. Yu just provided, that's the net. That's the net interest.

John Charles - Piper Jaffray - Analyst

Okay. Got it. All right. Thank you so much, guys. Congratulations, again, on the good quarter.

Unidentified Company Representative

Thank you, John.

Operator

(Operator Instructions)

Your next question comes from the line of Lisa Soh with Macquarie. Please proceed.

Lisa Soh - Macquarie - Analyst

Hi. Can you hear me clearly?

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Unidentified Company Representative

Yes, we can.

Lisa Soh - *Macquarie - Analyst*

Hi. My first question is -- of your revenue growth in wireless coverage in the second quarter, can you breakdown how much of that was from 3G versus 2G?

Ying Liu - *China Grentech Corp. Ltd. - Deputy General Manager - Wireless Coverage*

(spoken in foreign language)

Unidentified Company Representative

Lisa, Ms. Liu answered your question. She just said that it's really difficult to divide wireless coverage revenue into 2G and 3G because part of that network is commonly used by both networks. So it's really hard to have a clear cut there.

Ying Liu - *China Grentech Corp. Ltd. - Deputy General Manager - Wireless Coverage*

(interpreted) But what I can tell you is overall, the revenue from 3G, it's bigger than 2G.

Qingchang Liu - *China Grentech Corp. Ltd. - Vice-President - Corporate Finance*

(spoken in foreign language)

Unidentified Company Representative

Mr. Liu just added to the answer. He said Ms. Liu says 3G revenue is bigger than 2G. That really means 3G network plus the part that really can be used by 2G as well compared to the network that only accommodates 2G network. Is that clear?

Lisa Soh - *Macquarie - Analyst*

Yes, that is clear. Thank you. And my second question is -- the decrease in ASP that you saw wireless coverage equipment that impacted your margins in the second quarter, can you give us a little bit more detail as to what kind of decreases you're seeing in ASPs and how much of that is due to just a normal decline in ASP versus giving of any larger volume discounts?

Rong Yu - *China Grentech Corp. Ltd. - Director, CFO*

(interpreted) Overall, the ASP decrease in 2009 is relatively smaller than in 2008. Normally, we would not give additional discounts after the contract bid. I know before we mentioned about offering discounts. But that's really related to our strategy to speed up collection of our aged account receivable.

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Lisa Soh - *Macquarie - Analyst*

Okay. Great. And my final question is -- you were one of the top three for China Telecom's centralized equipment bid. Can you give us a little bit of color as to the price differentials between central procurements and provincial procurements projects?

Ying Liu - *China Grentech Corp. Ltd. - Deputy General Manager - Wireless Coverage*

(spoken in foreign language)

Unidentified Company Representative

Ms. Liu just answered the question. She said there really is no price difference between -- you just mentioned the centralized bidding and to -- going into the provincial level because, right now, the operators will ask all the provincial level to strictly follow the centralized bidding pricing right there. And also, the contract is signed at group level. And then the projects carry through to the provincial levels. So in other words, the ASP, it's the same price, which is decided in the centralized bidding.

Qingchang Liu - *China Grentech Corp. Ltd. - Vice-President - Corporate Finance*

(spoken in foreign language)

Unidentified Company Representative

Mr. Liu just added to the answer. He says there is a difference between the centralized -- I would say the difference between the centralized bidding and the provincial level is that for the centralized bidding, it's only for equipment procurement. But at provincial level, that also includes the integration service projects.

Qingchang Liu - *China Grentech Corp. Ltd. - Vice-President - Corporate Finance*

(interpreted) Overall, gross profit margin for wireless coverage is around 30%. And based on our past record that for integration services, the margin is bigger than -- larger than 30%. And for the equipment part, actually, it's less than 30%. So there is a gross profit margin difference between the two.

Lisa Soh - *Macquarie - Analyst*

All right. Thank you very much.

Unidentified Company Representative

Welcome.

Operator

And at this time, there are no other questions in the queue. I'd like to turn the call back over to China Grentech management for closing remarks.

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Unidentified Company Representative

Thank you, again, for joining us today. We look forward to updating you on our progress.

Operator

Thank you, all, for your participation in today's conference call. This concludes the presentation. And you may now disconnect.

Editor

Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the Company sponsoring this Event.

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