

FINAL TRANSCRIPT

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GRRF - Q3 2009 CHINA GRENTech CORP LTD Earnings Conference Call

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PRESENTATION

Operator

Welcome to China GrenTech's 2009 third 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 the Private Securities Litigation Reform Act of 1995. These statements are based upon GrenTech's management's current expectations and thus 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 to the Company. Please go ahead.

Unidentified Company Representative

Thank you, Operator, and thanks, everyone, for joining us on third quarter 2009 results conference call. Joining me today are Rong Yu, Director and Chief Financial Officer, Ying Liu, Head of Wireless Coverage Business, Qi Wang, Director and Vice President of RF Business, and Qingchang Liu, Vice President of Corporate Finance. As we 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 investor section, under financials.

After the overview of our strategy on slide four, the slides pertaining to our third quarter 2009 performance start on slide six. Slide six shows two charts detailing our top-line performance. On the left, you can see significant year-over-year growth in 2009, which is largely due to our ability to capitalize on the Chinese telecom operators' network investments. Our total revenue in the first nine months of 2009 has exceeded RMB1 billion and is more than what we booked in the entirety of 2008.

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Third quarter 2009 revenue grew by 85.8% over the same period last year and this quarter was one of the strongest quarters in our history from a revenue perspective. We have been consistently delivering strong financial performance across the board. The key to our ability to continue to reap these results from the demand for wireless coverage products and service is our leading market position and well-established and deepening relationship with the operators.

Revenue from our wireless coverage business, as shown on slide seven, increased in the third quarter by 97.7% year-over-year to around RMB309 million. Again, the key to our growth is strong demand from all three telecommunication operators, as they conduct extensive and fast-paced investment to upgrade their wireless coverage systems. Revenue from China Unicom increased by RMB108 million to RMB161 million, which is more than 40% of our wireless coverage segment revenues.

China Unicom intensified 3G wireless coverage construction in the third quarter, as they built up for the large-scale commercialization of their 3G network. China Mobile revenue were RMB86 million, a slight year-over-year decline despite an increase in the volume of business.

This is the result of a higher proportion of revenue being allocated to integrated service. Because we recognize revenue for service upon completion of inspection, this revenue will be recognized as the inspection certificates, and we expect to receive these certificates over the next few quarters.

Revenue from China Telecom increased by about RMB47 million, and reached RMB52 million and we are benefiting from the proposed restructuring 3G network construction plans. And now come to our base station RF part of business, highlighted on slide eight. In third quarter, China Mobile commenced phase III TD-SCDMA network construction. China Telecom and China Unicom both continued their CDMA2000 and WCDMA network expansion initiatives.

This continued network construction and expansion drove demand for our base station RF products. At the same time, revenue for global base station manufacturers increased significantly and contributed more than 30% of the base station RF business revenue in the third quarter of 2009. As a result, our revenue from base station RF products increased by around 52% versus the third quarter of 2008 to about RMB86 million. Next, on slide nine, operating income significantly increased and net income has been positively impacted by the substantial revenue increase and tightened cost control measures. Operating expenses as a percentage of total revenue decreased further this quarter to 19.1%, versus 28.3% in the year-ago quarter.

This significant progress demonstrates our model scalability, as we have shown our ability to drive profitability as we increased the scale of our business. We continued to streamline our cost base and operation and our commitment to improve an operating efficiency and tightening cost control remains.

Our cost-centric mentality, along with our focused strategy to drive revenue growth has delivered another quarter of strong earnings. I will now go through the financials. Beginning with the income statement on slide 11, as telecommunication operators' network construction continues revenue in the third quarter of 2009, increased by 85.8% year-over-year to RMB395 million, gross profit increased 67.4% year-over-year to RMB105.2 million, and gross margin increased to 26.6% in the third quarter 2009 from 29.6% in the same period last year.

The gross margin decrease was partly due to a decline in the average selling price of wireless coverage equipment, due to the centralized bidding. This was partially offset by the increase in sales volume. Operating income in the third quarter 2009 was RMB29.8 million, as compared to operating income of RMB2.7 million in the third quarter 2008.

Net income for the third quarter 2009 was RMB20.1 million, as compared to a net loss of RMB8.4 million in the third quarter 2008. Again, demonstrating that we are able to scale the business profitably.

Turning to our balance sheet on slide 12, cash, cash equivalents and [prep] time deposits were RMB140.3 million, as of September 30, 2009. The year-to-date decrease is mainly due to working capital outflow for raw material purchase to meet our increasing demand and operating overhead. Total accounts receivable increased by 22.6%. Sales December 31st, 2008, ended about



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RMB1.6 billion as of September 30, 2009, primarily due to the significant revenue growth and because the majority of sales in the third quarter 2009 have not yet entered into the respective collection periods at the end of the quarter.

Inventory increased by 66.2% to RMB865.1 million as of September 30, 2009, mainly due to increased raw material purchase to meet sales orders and higher level of finished goods that have been installed but have not yet been recognized as revenue, because there's completion certificates and inspection certificates have not been received.

Total assets increased by 14.2% to around RMB4.2 billion as of September 30, 2009, mainly due to increase in inventory and total accounts receivable. Total liabilities increased by 26.3% to approximately RMB1.8 billion, and current liabilities increased by 30.7% to about RMB1.7 billion as of September 30, 2009. The increase in liabilities was mainly due to an increased RMB293.8 million account payable and bills payable for raw material purchases and an increased RMB106 million in short-term bank loans.

I will now move onto our business outlook on slide 14. We expect wireless coverage business will remain strong in the fourth quarter of 2009 primarily due to the following factors. We believe that China's telecommunication operators will continue construction of their nationwide 3G network to 2011 and that wireless coverage network will continue over an extended period of time.

We expect that we will continue to receive orders for new 3G wireless coverage construction project in the fourth quarter and coming years. Additionally, the operators are allocating more resources for wireless LAN construction and GrenTech has won the bid for both China Mobile and China Telecom's wireless LAN recruitment contracts. These factors will provide growth opportunities for the Company.

In the fourth quarter, GrenTech expects to receive more completion certificates or inspection certificates for those finished goods that have been installed in customer sites. And therefore we will be able to recognize the revenue for those products. For the base station RF module business, we expect demand for fourth quarter 2009 to increase over the third quarter 2009, primarily due to the following factors. China Unicom's double CDMA network construction in second-tier cities and China Mobile's TD-SCDMA phase III construction will complete by the end of the year. And China Telecom's CDMA2000 network expansion will continue in the fourth quarter 2009. We believe these factors will continue to drive demand growth for the base station RF business.

In the beginning of the fourth quarter 2009, we will begin bulk supplies of our newly developed GSM module to domestic base station manufacturers. At the same, we expect demand from overseas base station manufacturers to remain stable. Finally, I will turn to our guidance for the full year 2009 and the fourth quarter of 2009 on slide 16.

We estimate the revenue for the fourth quarter of 2009 will range between RMB485 million and RMB505 million, due to the continued enhancement in major cities' wireless coverage network and embarking on coverage network construction in second-tier cities. The demand for the wireless coverage and base station RF business remains strong. We raise our full-year revenue growth guidance from over 40% to between 61% and 63% and the range will be between RMB1.85 billion and RMB1.6 billion. We believe the continued 3G network construction will benefit our business in the near future. And, with that, we will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions).

Your first question comes from the line Ms. Adele Mao of DLT Global.

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Adele Mao - OLT Global - Analyst

Hi. I have a couple questions. First of all, could you discuss how you foresee the revenue mix between wireless coverage and RF products to trend for the fourth quarter and 2010 and how sustainable the gross margins are for each business. (spoken in foreign language).

Unidentified Company Representative

Mr. Liu will be answering your question.

Qingchang Liu - China GrenTech - VP - Corporate Finance

(interpreted) According to the revised guidance for our full year 2009, the revenue mix between the wireless and the RF will be 75% and 25%. However, at this stage, we are not ready to give out the guidance for 2010, because we have to wait for the telecom operators in terms of their capital expenditure to unfold.

Overall, we do not expect significant change in terms of the mix. On the gross margin for wireless coverage, although the centralized bidding system does have an impact on our equipment sales margins, we receive a bit of the pressure on the pricing. However, as we continued to improve our operational efficiency and benefits from our scalability, it basically helped us to maintain the initial guidance on the margins of the early of the year, which is between 26% to 27%.

As for the outlook in 2010 on the pricing, it's still yet for us to assess. However, from what we see from the telecom operators, they are less sensitive on the pricing. Rather, we see that they focus more on the overall technology capability, as well as the overall capacity of the company as the more important selection criteria.

As to the impact on the pricing, at this stage we cannot give any visibility at this stage, not until we -- the tendering process started and also we will see how the different competitors bid on prices. Thank you.

Adele Mao - OLT Global - Analyst

Okay, that's fair. Thank you. You indicated in the press release that some finished goods were already installed on the customer side but have not yet been recognized as revenue, because the inspection has not been completed yet. Can you just break out the inventory that is currently in finished goods? (spoken in foreign language).

Unidentified Company Representative

Ms. Yu, the CFO, will answer the question.

Rong Yu - China GrenTech - CFO

(interpreted) For the end of the Q3, the inventory level is at RMB865 million. And out of the RMB865 million, roughly about RMB330 million are finished goods, and that we expect we'll be able to recognize as revenue in the fourth quarter.

Adele Mao - OLT Global - Analyst

Okay, that's good. Well, your guidance implies actually a slight year-over-year decline in total revenue for the fourth quarter. Given all the wireless coverage initiatives that you highlighted earlier and the fact that RF business will continue to grow in the

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fourth quarter, I would think there should be some level of growth. Are you simply being conservative, or there may be other factors that may present uncertainties in your fourth quarter revenue trend? (spoken in foreign language).

Unidentified Company Representative

Firstly, I would like to sort of rectify the answer we just rendered regarding the finished goods. Out of the RMB865 million of inventories, roughly about RMB330 million of finished goods will be recognized as revenue in the next few quarters, not only in Q4, but in the next few quarters. Thank you.

Mr. Liu answered the questions.

Qingchang Liu - *China GrenTech - VP - Corporate Finance*

Now, although when we compare the Q4 guidance versus the last year's, it seems to be slightly lower, but however we should focus on the full-year growth. We have already revised up the guidance from 40% to a full annual growth of 61% to 63%. The main reason for the fourth quarter this year is slightly lower than last year is mainly because the first three quarters in 2009 are much more, are much higher, and then it basically has less fluctuations, comparatively. Is the answer clear to you?

Adele Mao - *OLT Global - Analyst*

Yes, I think that's certainly helpful. Thank you very much. That's all my questions.

Unidentified Company Representative

Thank you.

Operator

(Operator Instructions)

Your next question comes from the line of Charlie John from Piper Jaffray.

Charles John - *Piper Jaffray - Analyst*

Hi. Thanks for taking my questions. The first question I have is just on the overall macro, what we've heard from some of our checks is the CapEx for 2010 is going to be flat to slightly down, and one of the reasons being the lack of local number portability, so with some of the customers of China Mobile unable to move to China Unicom or China Telecom, we're not seeing as quick a 3G ramp as people would have liked. So I guess a two-part question. One is when do you expect local number portability to happen? And, two, do you think CapEx will be flat to slightly down? Or do you think the actual rate could build next year, and could CapEx be up in 2010? Thank you.

Unidentified Company Representative

(interpreted) According to the information we gather from the telecom operators, the total CapEx spending for 2010 seems to be slightly lower than 2009. However, for the business that's relevant to us, which is the wireless coverage, we believe that the CapEx spending in 2010 will not decrease.

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One of the main reasons is the 3G construction by the telecom operators will carry on until the 2011. And also the construction period for the wireless coverage network will be longer than that of the base station network. And because of that we believe the demand for our services and products will remain strong in the year 2010. Thank you.

Operator

Your next question comes from the line of Chang Qiu of Sansar Capital.

Chang Qiu - Sansar Capital - Analyst

Yes, just one question regarding the interest income. It looks like you have some interest income from account receivables, and just wonder how that can be.

Unidentified Company Representative

(interpreted) The interest income mainly derives from the sales discount that we have. Because in our wireless coverage business, both the inspection as well as the warranty cycle is actually beyond one year, according to the US GAAP, for the revenue recognized, if it's recognized over the period of one year, we'll give a discount.

Chang Qiu - Sansar Capital - Analyst

Okay, that's --

Unidentified Company Representative

(interpreted) If it's below one year, then it will be treated as interest income. So, basically, for the year of 2009, we estimate the interest income on this will amount to roughly about 30 million, compared to 2008, which is 25 million.

Chang Qiu - Sansar Capital - Analyst

Okay, that helps. Another point, could you -- in your wireless coverage revenue, can you split out how many percentage to the equipment, how many percent of the revenue is to the integrated service? (spoken in foreign language).

Unidentified Company Representative

I just want to sort of repeat the answer by Ms. Yu, the CFO.

Rong Yu - China GrenTech - CFO

(interpreted) The speed of the revenue between the equipment and the integration services for the Q3 is 54% and 46%, but we target for year 2009, the split will be 60% and 40%.

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Chang Qiu - Sansar Capital - Analyst

And the third question is the other revenue. You mentioned you rented out part of your Gouren building to other parties, and this RMB1.2 million, is that for the renting for the whole quarter or just a part of the quarter? Should that amount be sustainable for the future quarters? (spoken in foreign language).

Unidentified Company Representative

(interpreted) At the moment, we still have vacancies in the building that we could rent it out for the Q3 -- quarter three, at the third quarter, the tenant just came in. But, going forward, if we assume that all the vacancies will be filled be able to rent it out, we estimate the revenue coming from it will be roughly about \$1 million to \$2 million per annum. Of course, depending on sort of the percentage of how much of that we can rent out.

Chang Qiu - Sansar Capital - Analyst

Okay. Okay, thank you.

Operator

Your next question comes from the line of Ms. Lisa Soh from Macquarie.

Lisa Soh - Macquarie - Analyst

Hi, guys. Thanks for taking my question. My first question is just regarding your tax rate guidance of the fourth quarter, because I understand that you should get some tax rebates back in the fourth quarter, so can you give us some guidance there? And then, secondly, regarding your fourth quarter revenue guidance, which is slightly down year-on-year, and I know that you said that there was some seasonality there. Could it also be said that given that you saw so much spending from the operators in Q1 through to Q3 that they are fast approaching their CapEx budget for the year, which is why your fourth quarter guidance is slightly down? Because typically the seasonality is for a very big fourth quarter. So I was wondering if you could give us some more color there.

Unidentified Company Representative

Mr. Liu answered the questions regarding the Q4 revenue guidance.

Qingchang Liu - China GrenTech - VP - Corporate Finance

(interpreted) In the past years, 4Q is higher than the first three quarters in 2008. However, year 2009 is slightly different, because the acceleration of the construction has commenced from the first quarter onward and continued to build out throughout the second and the third quarter. So, relatively, you can see that sort of the increase would not be that significant.

Well, the second point I want to mention is this does not represent that CapEx spending has sort of slowed down. Rather, in this fourth quarter, the enhancement in terms of the enhancement in the network continued in the major cities, and then the commencement of the construction of the network will start in sort of the second-tier cities. So, broadly, it's roughly about 1% to 2% of our total revenue for the rebate.

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Lisa Soh - Macquarie - Analyst

And, sorry, can I just ask a follow-up question? Does the slight change in the seasonality that you're going to see in 2009, do you expect that to reverse in 2010 or is it a little bit too early to have much clarity on that?

Unidentified Company Representative

(interpreted) Although we cannot give a lot of visibility in terms of the seasonality in the year 2010, but we would not expect the seasonality will be as drastic as compared in year 2008 or before.

To support our argument is mainly from the spending of the telecom operators in the construction of 3G network, to continue on. But as to the pace, the pattern and the seasonality of it, we're yet to sort of see it from the telecom operators, when they start their bidding.

Lisa Soh - Macquarie - Analyst

Okay, thanks, guys.

Operator

Your next question comes from the line of [Cheo Wang] of Main First.

Cheo Wang - Main First - Analyst

Hi. My first question is what percentage of revenue is 3G related?

Unidentified Company Representative

(interpreted) From both of our business is roughly about 70% is derived from 3G-related products.

Cheo Wang - Main First - Analyst

Second question is that which operator do you expect will contribute most to your revenue growth going forward?

Unidentified Company Representative

(interpreted) For 2009, China Unicom, they invest much more in the coverage and then it's also our largest contributor in terms of revenue. However, in the year 2010, there is not enough visibility at this stage, as yet, and however we hope to gain more visibility in our fourth quarter and be able to give you more information on that.

Cheo Wang - Main First - Analyst

Okay, my third question, that your revenue from China Telecom is still quite low, around one-third of China Unicom, and according to local press that China Telecom is quite aggressive on their network building, so what's your comment on that? And as China Telecom CDMA is transferred from China Unicom, so I just assume that GrenTech has quite a close relationship with China Telecom. Am I right?



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Unidentified Company Representative

Ms. Liu, the Head of our Wireless Coverage Networks business answered this question. She mentioned about from the official figures.

Ying Liu - China GrenTech - Head - Wireless Coverage

(interpreted) It seems that the capital spending in building the network for China Telecom seems to be slightly higher than China Unicom. But, in fact, in reality, because of the focus on the 3G network expansions, the expenditure is slightly lower than China Unicom. China Unicom is the one that's spending more.

Cheo Wang - Main First - Analyst

So you think that China Telecom will spend more going forward?

Ying Liu - China GrenTech - Head - Wireless Coverage

(interpreted) For the year 2010, China Telecom will invest heavily in building the WLAN network.

Cheo Wang - Main First - Analyst

So will you benefit from WLAN?

Ying Liu - China GrenTech - Head - Wireless Coverage

(interpreted) Yes, it will.

Operator

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

Charles John - Piper Jaffray - Analyst

Thanks. Just to follow-up on a housekeeping question. In your P&L, you have a line item saying other revenue of 1.25 million. Can you just help us think about this? Does this go into COGS? Do we put it as a separate line item? Could you just give us some more color there?

Unidentified Company Representative

(interpreted) The other income of 1.25 million was the rental income from renting out some of the office space in our building in the third quarter. Going forward, because there are still spaces in our building that can be sort of renting out, if we can sort of rent out all of them, the maximum rental revenue we can get from it per annum will be \$2 million.



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Charles John - Piper Jaffray - Analyst

And why is it not being included in the gross margin? So why are we keeping it out of the two main revenue line items?

Qingchang Liu - China GrenTech - VP - Corporate Finance

This is according to the US GAAP.

Unidentified Company Representative

This is according to the US GAAP, from Mr. Liu. That's the response to it.

Charles John - Piper Jaffray - Analyst

Okay, all right, perfect. And then another quick question. Can you give the breakout for gross margin between your two divisions for this quarter and maybe your expectations for next quarter?

Rong Yu - China GrenTech - CFO

(interpreted) The gross margin for the RF business we maintain at 18% and will be so for the year of 2009. On the wireless coverage, because of the downwards pressure of the ASP, on the equipment sales, the gross margin sort of is roughly about 25%, and for the integration services, it's roughly about 30% to 35% for the third quarter. But for the year 2009, we are confident that we will be able to maintain the margin at about 26% to 27%.

Charles John - Piper Jaffray - Analyst

Okay, thank you very much.

Unidentified Company Representative

Thank you.

Operator

Ladies and gentlemen, that concludes the Q&A session. I would now like to turn the call back over to management.

Unidentified Company Representative

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

Operator

Ladies and gentlemen, that concludes the presentation. Thank you for your participation. You may now disconnect. Have a great day.

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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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