CHINA FIRE & SECURITY GROUP, INC.
Form 10-K/A
October 30, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 1 TO
FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period ______________ to ______________

Commission file number: 001-33588

CHINA FIRE & SECURITY GROUP, INC.
(Exact name of registrant as specified in its charter)

Florida (State of incorporation)	65-1193022 -family: Times New Roman,serif">Principal Amount:	$50 per note
Initial Trade Date:	August 1, 2018	
Initial Issue Date:	August 6, 2018	
Term:	19 years and 5 months, subject to your right to require us to redeem your notes on any Redemption Date, our call right or our right to extend the maturity date, each as described below.	

BMO CAPITAL MARKETS *(cover continued on next page)*

Maturity Date*:	January 8, 2038, which is scheduled to be the third Business Day following the last Index Business Day in the Final Measurement Period. The Maturity Date may be extended at our option for up to two additional 5-year periods, as described herein. The Maturity Date is also subject to adjustment as described herein and under "Specific Terms of the Notes — Market Disruption Events."
Listing:	The notes are listed, subject to official notice of issuance, on the NYSE Arca, Inc. (the "NYSE") under the ticker symbol listed below. The CUSIP and ISIN numbers, and the Intraday Indicative Value ticker symbol, for the notes are:

Ticker Symbol	**CUSIP Number**	**ISIN Number**	**Intraday Indicative Value Symbol**
FNGZ	063679849	US0636798490	FNGZIV

	If an active secondary market develops, we expect that investors will purchase and sell the notes primarily in this secondary market.
Index:	The return on the notes is linked to a two times leveraged participation in the inverse performance of the NYSE FANG+™ Index, total return, compounded daily, minus the applicable fees. The Index is an equal-dollar weighted index designed to represent a segment of the technology and consumer discretionary sectors consisting of highly-traded growth stocks of technology and tech-enabled companies. The Index currently has 10 constituents.
Payment at Maturity/Cash Settlement Amount:	If you hold your notes to maturity, you will receive a cash payment in U.S. dollars at maturity in an amount equal to the arithmetic mean of the closing Indicative Note Values on each Index Business Day in the Final Measurement Period. This amount will not be less than zero.
Indicative Note Value:	On the Initial Trade Date, the Indicative Note Value of each note will equal the Principal Amount of \$50. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the closing Indicative Note Value will equal (a) the Deposit Amount on such Exchange Business Day *minus* (b) the Short Index Amount on such Exchange Business Day; provided that if such calculation results in a value equal to or less than \$0, the closing Indicative Note Value will be \$0. If the closing Indicative Note Value is \$0 on any Exchange Business Day or the Intraday Indicative Value at any time during an Exchange Business Day is equal to or less than \$0, then the Indicative Note Value on all future Exchange Business Days will be \$0. ***If the Indicative Note Value is zero, the Cash Settlement Amount will be zero.***
Deposit Amount:	On the Initial Trade Date, the Deposit Amount will equal the principal amount *plus* the Short Index Amount on the Initial Trade Date, which sum equals \$150. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the Deposit Amount will equal (a) the closing Indicative Note Value on the immediately preceding Exchange Business Day *times* the Daily Deposit Factor *plus* (b) the Daily Interest on such Exchange Business Day *minus* (c) the Daily Investor Fee

	on such Exchange Business Day.
Short Index Amount:	On the Initial Trade Date, the Short Index Amount will equal the Daily Leverage Factor *times* the principal amount, which equals $100. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the Short Index Amount will equal the product of (a) the closing Indicative Note Value on the immediately preceding Exchange Business Day *times* (b) the Daily Leverage Factor *times* (c) the Index Performance Factor on such Exchange Business Day.
Daily Leverage Factor:	2
Daily Deposit Factor:	3
Index Performance Factor:	On the Initial Trade Date, the Index Performance Factor will be 1. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the Index Performance Factor will equal (a) the Index Closing Level on such Exchange Business Day (or, if such day is not an Index Business Day, the Index Closing Level on the immediately preceding Index Business Day) *divided by* (b) the Index Closing Level on the immediately preceding Index Business Day, as determined by the Calculation Agent. If a Market Disruption Event occurs or is continuing on any Index Business Day, the Calculation Agent will determine the Index Performance Factor for the notes on each such Index Business Day using an appropriate closing level of the Index for each such Index Business Day taking into account the nature and duration of such Market Disruption Event. Furthermore, if a Market Disruption Event occurs and is continuing with respect to the notes on any Index Business Day or occurred or was continuing on the immediately preceding Index Business Day, the calculation of the Index Performance Factor will be modified so that the applicable leveraged exposure does not reset until the first Index Business Day on which no Market Disruption Event with respect to the notes is continuing.

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Daily Interest:	On the Initial Trade Date, the Daily Interest will be $0. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the Daily Interest will equal the product of (a) the closing Indicative Note Value on the immediately preceding Exchange Business Day *times* (b) the Daily Deposit Factor *times* (c) the Daily Interest Rate *divided by* (d) 365 *times* (e) the number of calendar days since the last Exchange Business Day. Because the Daily Interest is calculated and added to the Deposit Amount on a daily basis, the net effect of the Daily Interest accrues over time. The Daily Interest Rate will vary in time and can become negative on certain days. On such days, the Daily Interest will also be negative.
Daily Interest Rate:	The Daily Interest Rate will equal (a) the most recent US Federal Funds Effective Rate *minus* (b) 1.00%. The US Federal Funds Effective Rate is an interest rate that represents the rate at which U.S. banks may lend reserve balances to other depository institutions overnight, on an uncollateralized basis. The rate is released by the NY Federal Reserve each day at approximately 9:00 a.m. EST for the prior business day and published on Bloomberg L.P. (including any successor, “Bloomberg”) page “FEDL01 Index”. On the days, when the US Federal Funds Effective Rate is lower than 1.00%, the Daily Interest Rate will be negative.
Daily Investor Fee:	On the Initial Trade Date, the Daily Investor Fee will be $0. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the Daily Investor Fee will equal the product of (a) the Indicative Note Value at the close of the immediately preceding Exchange Business Day *times* (b) the Fee Rate *divided by* (c) 365 *times* (d) the number of calendar days since the last Exchange Business Day. Because the Daily Investor Fee is subtracted from the Deposit Amount and the Deposit Amount is calculated as part of the closing Indicative Note Value on a daily basis, the net effect of the Daily Investor Fee accumulates over time and is subtracted at a rate per year equal to the Fee Rate specified below. Because the net effect of the Daily Investor Fee is a fixed percentage of the value of the notes, the aggregate effect of the Daily Investor Fee will increase or decrease in a manner directly proportional to the value of the notes and the amount of notes that are held.
Fee Rate:	0.95% per annum
Call Right:	On any Index Business Day on or after February 6, 2019 through and including the Maturity Date (the “Call Settlement Date”), we may redeem all, but not less than all, of the issued and outstanding notes. To exercise our call right, we must provide notice to the holders not less than 14 calendar days prior to the Call Settlement Date. If we exercise our Call Right, you will receive a cash payment equal to the Call Settlement Amount, which will be paid on the Call Settlement Date.
Call Settlement Amount:	If we exercise our Call Right, for each note, you will receive on the Call Settlement Date a cash payment equal to the arithmetic mean of the closing Indicative Note Values on each Index Business Day in the Call Measurement Period.
Early Redemption:	Subject to your compliance with the procedures described under “Specific Terms of the Notes — Early Redemption at the Option of the Holders,” upon early redemption, you will receive per note a cash payment on the relevant Redemption Date equal to (a) Indicative Note Value as of the Redemption Measurement Date *minus* (b) the Redemption Fee Amount. We refer to this cash payment as the “Redemption Amount.”

Redemption Fee Amount:	As of any Redemption Date, an amount per note in cash equal to the product of (a) 0.125% and (b) the Indicative Note Value.

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Initial Index Level:	2,778.99, which was the Index Closing Level on the Initial Trade Date.
Index Closing Level:	On any Index Business Day, the closing level of the Index as reported on Bloomberg under the symbol “NYFANGT<Index>”, subject to adjustment as described under “Specific Terms of the Notes — Market Disruption Events.”
Intraday Indicative Value:	The Intraday Indicative Value of the notes at any time during an Exchange Business Day will equal (a) the Deposit Amount *minus* (b) the Intraday Short Index Amount; provided that if such calculation results in a value equal to or less than $0, the Intraday Indicative Value will be $0. If the Intraday Indicative Value is equal to or less than $0 at any time on any Exchange Business Day, then both the Intraday Indicative Value and the closing Indicative Note Value on that Exchange Business Day, and on all future Exchange Business Days, will be $0.
Intraday Short Index Amount:	The Intraday Short Index Amount will equal the product of (a) the closing Indicative Note Value on the immediately preceding Exchange Business Day *times* (b) the Daily Leverage Factor *times* (c) the Intraday Index Performance Factor.
Intraday Index Performance Factor:	The Intraday Index Performance Factor will equal (a) the most recently published level of the Index *divided by* (b) the Index Closing Level on the immediately preceding Index Business Day.
Calculation Agent:	BMO Capital Markets Corp.

The notes are designed to reflect a 2x inverse leveraged exposure to the performance of the Index on a daily basis, but the returns on the notes over different periods of time can, and most likely will, differ significantly from two times the return on a direct inverse investment in the Index. Also, the Index is potentially volatile as it includes only a small number of constituents (10, as of the date of this pricing supplement); any Index volatility would be magnified by the leverage. Accordingly, the notes should be purchased only by knowledgeable investors who understand the potential consequences of investing in the Index and of seeking daily compounding leveraged investment results. Investors should actively and continuously monitor their investments in the notes, even intra-day.

Because your investment in the notes is linked to a two times leveraged participation in the inverse performance of the Index, compounded daily, an increase in the level of the Index will have a negative effect on the Cash Settlement Amount, Call Settlement Amount or Redemption Amount, as applicable, whereas a decrease in the level of the Index will have a positive effect on those payment amounts. Because your investment in the notes is two times leveraged, any increase in the level of the Index will result in a significantly greater decrease in the Cash Settlement Amount, Call Settlement Amount or Redemption Amount, as applicable, (before taking into account any negative Daily Interest and the Daily Investor Fee) and you may receive less than your original investment in the notes at maturity, call or upon redemption, or if you sell your notes in the secondary market. Due to leverage, the notes are very sensitive to changes in the level of the Index

and the path of such changes. Moreover, because the Daily Investor Fee and any negative Daily Interest may substantially reduce the amount of your return at maturity, call or upon redemption, the level of the Index must decrease significantly in order for you to receive at least the principal amount of your investment at maturity, call or upon redemption, or if you sell your notes. If the level of the Index increases or does not decrease sufficiently to offset the negative effect of the Daily Investor Fee and any negative Daily Interest, you will receive less than the principal amount of your investment at maturity, call or upon redemption, or if you sell your notes.

On the Initial Trade Date, we sold $50,000,000 aggregate principal amount of the notes to BMO Capital Markets Corp. ("BMOCM") at 100% of their stated Principal Amount. After the Initial Trade Date, we may sell from time to time a portion of the notes at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. We will receive proceeds equal to 100% of the price at which the notes are sold to the public, less any commissions paid to BMOCM. BMOCM may charge normal commissions in connection with any purchase or sale of the notes. Please see "Supplemental Plan of Distribution (Conflicts of Interest)" for more information.

We may use this pricing supplement in the initial sale of the notes. In addition, BMOCM or another of our affiliates may use this pricing supplement in market-making transactions in the notes after their initial sale. ***Unless we or our agent informs you otherwise in the confirmation of sale or in a notice delivered at the same time as the confirmation of sale, this pricing supplement is being used in a market-making transaction.***

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You should read this pricing supplement together with the prospectus supplement dated April 27, 2017 and the prospectus dated April 27, 2017. **This pricing supplement, together with the documents listed below, contains the terms of the notes and supersedes all other prior or contemporaneous oral statements as well as any other written materials including preliminary or indicative pricing terms, correspondence, trade ideas, structures for implementation, sample structures, fact sheets, brochures or other educational materials of ours or the agent.** We urge you to consult your investment, legal, tax, accounting and other advisers before you invest in the notes. The contents of any website referred to in this pricing supplement are not incorporated by reference in this pricing supplement, the accompanying prospectus supplement or prospectus.

You may access these documents on the SEC website at www.sec.gov as follows (or if such address has changed, by reviewing our filings for the relevant date on the SEC website):

- Prospectus supplement dated April 27, 2017:

  https://www.sec.gov/Archives/edgar/data/927971/000119312517142764/d381374d424b5.htm
- Prospectus dated April 27, 2017:

  https://www.sec.gov/Archives/edgar/data/927971/000119312517142728/d254784d424b2.htm

Our Central Index Key, or CIK, on the SEC website is 927971. As used in this pricing supplement, “we,” “us” or “our” refers to Bank of Montreal.

The notes described in this pricing supplement are not appropriate for all investors, and involve important legal and tax consequences and investment risks, which should be discussed with your professional advisers. You should be aware that the regulations of the Financial Industry Regulatory Authority, Inc., or FINRA, and the laws of certain jurisdictions (including regulations and laws that require brokers to ensure that investments are suitable for their customers) may limit the availability of the notes. This pricing supplement and the accompanying prospectus supplement and prospectus do not constitute an offer to sell or a solicitation of an offer to buy the notes in any circumstances in which such offer or solicitation is unlawful.

SUMMARY

The following is a summary of terms of the notes, as well as a discussion of factors you should consider before purchasing the notes. The information in this section is qualified in its entirety by the more detailed explanations set forth elsewhere in this pricing supplement and in the accompanying prospectus supplement and accompanying prospectus.

What are the notes?

The notes are senior unsecured medium-term notes issued by Bank of Montreal with a return linked to a two times leveraged participation in the inverse performance of the Index, compounded daily, less a Daily Investor Fee, any negative Daily Interest and, if applicable, the Redemption Fee Amount. Accordingly, the notes generally appreciate in value as the level of the Index decreases, provided such decrease is sufficient to offset the cumulative negative effect of the Daily Investor Fee and any negative Daily Interest. The Index is an equal-dollar weighted index designed to represent a segment of the technology and consumer discretionary sectors consisting of highly-traded growth stocks of technology and tech-enabled companies. The Index has 10 constituents as of the date of this pricing supplement. The Index is a total return index. For a detailed description of the Index, see "The Index."

We refer to the securities included in the Index as the "Index constituents" and the issuers of those securities as the "constituent issuers."

The notes do not guarantee any return of principal at, or prior to, maturity or call, or upon early redemption. Instead, at maturity, you will receive a cash payment equal to the arithmetic mean of the closing Indicative Note Values on each Index Business Day in the Final Measurement Period. We refer to this cash payment as the "Cash Settlement Amount." This amount will not be less than zero. You may lose some or all of your investment at maturity. Because the Daily Investor Fee and any negative Daily Interest reduce your final payment, the level of the Index will need to have decreased over the term of the notes by an amount, after giving effect to the daily leverage and the compounding effect thereof, sufficient to offset the decrease in the principal amount represented by the Daily Investor Fee and any negative Daily Interest in order for you to receive an aggregate amount over the term of the notes equal to at least the principal amount of your notes. Due to leverage, the notes are very sensitive to changes in the level of the Index and the path of such changes. If the decrease in the level of the Index, measured as a component of the closing Indicative Note Value during the Final Measurement Period, is insufficient to offset the cumulative negative effect of the Daily Investor Fee and any negative Daily Interest, you will lose some or all of your investment at maturity. This loss may occur even if the Index Closing Level at any time during the Final Measurement Period is less than the Index Closing Level on the Initial Trade Date. See "Risk Factors—*The notes are not suitable for all investors. In particular, the notes should be purchased only by sophisticated investors who do not intend to hold the notes as a buy and hold investment,* *who are willing to actively and continuously monitor their investment and who understand the consequences of investing in and of seeking daily resetting leveraged investment results*." In addition, if the closing Indicative Note Value or the Intraday Indicative Value of the notes is equal to or less than $0, then the notes will be permanently worth $0 and the Cash Settlement Amount will be zero (a total loss of value).

The performance of the notes is linked to the leveraged participation in the inverse performance of the Index, compounded daily. There is no maximum limit to the level of the Index. Moreover, the notes are not principal protected. Therefore, an increase in the level of the Index could cause you to lose up to your entire investment in the notes.

Furthermore, because your investment in the notes is linked to a two times leveraged participation in the inverse performance of the Index, an increase in the level of the Index will have a negative effect on the Cash Settlement Amount, Call Settlement Amount or Redemption Amount, as applicable, whereas a decrease in the level of the Index will have a positive effect on those payment amounts. Because your investment in the notes is two times leveraged, any increase in the level of the Index will result in a significantly greater decrease in the Cash Settlement Amount, Call Settlement Amount or Redemption Amount, as applicable, before taking into account any negative Daily Interest and Daily Investor Fee, and you may receive less than your original investment in the notes at maturity, call or upon redemption, or if you sell your notes in the secondary market. Moreover, because the Daily Investor Fee and any negative Daily Interest may substantially reduce the amount of your return at maturity, call or upon redemption, or if you sell your notes, the level of the Index must decrease significantly in order for you to receive at least the principal amount of your investment. If the level of the Index increases or does not decrease sufficiently to offset the cumulative negative effect of the Daily Investor Fee and any negative Daily Interest, you will receive less than the principal amount of your investment at maturity, call or upon redemption, or if you sell your notes.

The returns on the notes are path dependent. The notes are designed to reflect a leveraged inverse exposure to the performance of the Index on a daily basis; their returns over different periods of time can, and most likely will, differ significantly from two times the inverse performance of the Index over such other periods of time. The notes are very sensitive to changes in the level of the Index, and returns on the notes may be negatively affected in complex ways by the volatility of the Index on a daily or intraday basis. Also, the Index is potentially volatile as it includes only a small number of constituents (10, as of the date of this pricing supplement); any Index volatility would be magnified by the leverage. Accordingly, the notes should be purchased only by knowledgeable investors who understand the potential consequences of investing in the Index and of seeking daily compounding leveraged inverse investment results. It is possible that you will suffer significant losses in the notes even if the long-term performance of the Index is flat or negative (before taking into account the negative effect of the Daily Investor Fee and the Daily Interest, and the Redemption Fee Amount, if applicable). Investors should actively and continuously monitor their investments in the notes.

The Daily Investor Fee accrues at a rate of 0.95% per annum. Because the Daily Investor Fee is subtracted from the Deposit Amount, and the Deposit Amount is calculated as part of the closing Indicative Note Value on a daily basis, the net effect of the Daily Investor Fee accumulates over time and is subtracted at a rate per year equal to the Fee Rate. Because the net effect of the Daily Investor Fee is a fixed percentage of the value of the notes, the aggregate effect of the Daily Investor Fee will increase or decrease in a manner directly proportional to the value of the notes and the amount of notes that are held.

On the Initial Trade Date, the Index Performance Factor will be 1. On any subsequent Exchange Business Day until maturity, call or redemption of the notes, the Index Performance Factor will equal (a) the Index Closing Level on such Exchange Business Day (or, if such day is not an Index Business Day, the Index Closing Level on the immediately preceding Index Business Day) divided by (b) the Index Closing Level on the immediately preceding Index Business Day, as determined by the Calculation Agent. If a Market Disruption Event occurs or is continuing on any Index Business Day, the Calculation Agent will determine the Index Performance Factor for the notes on each such Index Business Day using an appropriate closing level of the Index for each such Index Business Day taking into account the nature and duration of such Market Disruption Event. Furthermore, if a Market Disruption Event occurs and is continuing with respect to the notes on any Index Business Day or occurred or was continuing on the immediately preceding Index Business Day, the calculation of the Index Performance Factor will be modified so that the applicable leveraged exposure does not reset until the first Index Business Day on which no Market Disruption Event with respect to the notes is continuing.

“Business Day” means a Monday, Tuesday, Wednesday, Thursday or Friday that is neither a legal holiday nor a day on which banking institutions are authorized or obligated by law or executive order to close in New York City or Toronto.

"Exchange Business Day" means any day on which the primary exchange or market for trading of the notes is scheduled to be open for trading.

"Index Business Day" means any day on which the Index Sponsor (as defined below) publishes the Index Closing Level.

The scheduled Maturity Date is January 8, 2038, which is the third Business Day following the last Index Business Day in the Final Measurement Period, subject to adjustment as described herein and under "Specific Terms of the Notes — Market Disruption Events." The Maturity Date may be extended at our option for up to two additional five-year periods. We may only extend the scheduled Maturity Date for five years at a time. If we exercise our option to extend the maturity, we will notify The Depository Trust Company ("DTC") (the holder of the global note for the notes) and the trustee at least 45 but not more than 60 calendar days prior to the then scheduled Maturity Date. We will provide that notice to DTC and the trustee in respect of each five-year extension of the scheduled Maturity Date.

Unlike ordinary debt securities, the notes do not guarantee any return of principal at maturity or call, or upon early redemption. The notes do not pay any interest.

For a further description of how your payment at maturity or call, or upon early redemption, will be calculated, see "Specific Terms of the Notes — Cash Settlement Amount at Maturity," "— Call Right" and "— Early Redemption at the Optio the Holders."

Path Dependence and Daily Leverage Reset. Because the leverage of the notes is generally only reset once each day, it is likely that due to intra-day changes in the level of the Index, the leverage at any point during an Index Business Day can be higher or lower than the target leverage of -2.0.

The performance of the notes is path-dependent. This means that the value of the notes will depend not only upon the level of the Index at maturity, call or redemption, but also on the performance of the Index over each day that you hold your notes. In other words, the value of the notes will be affected by not only the increase or decrease in the level of the Index over a given time period but also the volatility of the level of the Index over such time period. For example, a sharp spike or sharp decline in the level of the Index at the end of a particular time period will not result in the same return as a gradual uptick or gradual decline in the Index over the same time period, even if the level of the Index at the end of the applicable time period is the same in each scenario. Accordingly, the return on the notes may not correlate with the return on the Index over periods longer than one day.

As a general matter, it is expected that the notes will have better returns if the Index trends from one level to another over multiple Index Business Days, rather than experiencing significant changes in opposite directions over multiple Index Business Days. Consequently, volatility of the Index level may have a significant negative effect on the value of the notes.

In addition, the performance of the notes is path dependent, insofar as their value at any time depends not only on the level of the Index at such time but also on the Index's level at any prior time. As a result, the value of your investment in the notes may diverge significantly from the value you might expect on the basis of the leverage strategy of the notes and changes in the level of the Index over the period that you hold them. See "Hypothetical Examples."

Early Redemption

You may elect to require us to redeem your notes (subject to a minimum redemption amount of at least 25,000 notes) on any Business Day commencing on the first Redemption Date (August 7, 2018) and ending on the final Redemption Date (which will be the last scheduled Index Business Day prior to the Calculation Date or Call Calculation Date, as applicable). If you elect to have your notes redeemed and have done so under the redemption procedures described in "Specific Terms of the Notes —Early Redemption at the Option of the Holders — Redemption Procedures," you will receive a cash payment on the Redemption Date equal to the Redemption Amount, as defined below. You must comply with the redemption procedures described below in order to redeem your notes. To satisfy the minimum redemption amount, your broker or other financial intermediary may bundle your notes for redemption with those of other investors to reach this minimum amount of 25,000 notes; however, there can be no assurance that they can or will do so. We may from time to time in our sole discretion reduce this minimum requirement in whole or in part. Any such reduction will be applied on a consistent basis for all holders of the notes at the time the reduction becomes effective.

Upon early redemption, you will receive per note a cash payment on the relevant Redemption Date equal to (a) the Indicative Note Value as of the Redemption Measurement Date minus (b) the Redemption Fee Amount. We refer to this cash payment as the "Redemption Amount." This amount will not be less than zero. You may lose some or all of your investment upon early redemption. Because the cumulative negative effect of the Daily Investor Fee, any negative Daily Interest and the Redemption Fee Amount reduce your final payment, the level of the Index will need to have decreased over the term of the notes by an amount, after giving effect to the daily leverage and the compounding effect thereof, sufficient to offset the decrease in principal amount represented by the Daily Investor Fee, any negative Daily Interest and the Redemption Fee Amount in order for you to receive an aggregate amount upon redemption equal to at least the principal amount. If the decrease in the level of the Index, as measured on the Redemption Measurement Date, is insufficient to offset such a negative effect, you will lose some or all of your investment upon early redemption. It is possible that you will suffer significant losses in the notes upon redemption even if the long-term performance of the Index is flat or negative (before taking into account the negative effect of the Daily Investor Fee, the Daily Interest and the Redemption Fee Amount).

Redemption Fee Amount: As of any Redemption Measurement Date, 0.125% of the Indicative Note Value.

For a detailed description of the redemption procedures applicable to an early redemption, see “Specific Terms of the Notes —Early Redemption at the Option of the Holders — Redemption Procedures.”

Call Right

On any Index Business Day on or after February 6, 2019 through and including the Maturity Date (the “Call Settlement Date”), we may at our option redeem all, but not less than all, of the issued and outstanding notes. To exercise our Call Right, we must provide notice to the holders of the notes not less than 14 calendar days prior to the Call Settlement Date specified by us. In the event we exercise this right, you will receive a cash payment equal to the arithmetic mean of the closing Indicative Note Values on each Index Business Day in the Call Measurement Period. We refer to this cash payment as the “Call Settlement Amount.” If we issue a call notice on any calendar day, the “Call Calculation Date” will be the next Index Business Day after the call notice is issued.

The Call Settlement Date will be the fifth Business Day following the last Index Business Day in the Call Measurement Period.

Call Measurement Period: The five Index Business Days from and including the Call Calculation Date, subject to adjustment as described under “Specific Terms of the Notes — Market Disruption Events.”

Understanding the Value of Notes

The initial offering price of the notes is determined at the inception of the notes. The initial offering price and the Intraday Indicative Value are not the same as the trading price, which is the price at which you may be able to sell your notes in the secondary market, or the Redemption Amount, which is the amount that you will receive from us in the event that you choose to have your notes repurchased by us. An explanation of each type of valuation is set forth below.

Initial Offering Price to the Public. The initial offering price to the public is equal to the Principal Amount of the notes. The initial offering price reflects the value of the notes only on the Initial Trade Date.

Intraday Indicative Value. The Intraday Indicative Value for the notes at any point in time of an Exchange Business Day will equal (a) the Deposit Amount minus (b) the Intraday Short Index Amount; provided that if such calculation results in a value equal to or less than $0, the Intraday Indicative Value will be $0. If the Intraday Indicative Value of the notes is equal to or less than $0 at any time on any Exchange Business Day, then both the Intraday Indicative Value of the notes and the closing Indicative Note Value on that Exchange Business Day, and on all future Exchange Business Days, will be $0. The Intraday Short Index Amount will equal the product of (a) the closing Indicative Note Value on the immediately preceding Exchange Business Day *times* (b) the Daily Leverage Factor *times* (c) the Intraday Index Performance Factor. The Intraday Index Performance Factor will equal (a) the most recently published level of the Index *divided by* (b) the Index Closing Level on the immediately preceding Index Business Day.

The Intraday Indicative Value is not the same as, and may differ from, the amount payable upon an early redemption, call or at maturity and the trading price of the notes in the secondary market. Because the Intraday Indicative Value uses an intraday Index level for its calculation, a variation in the intraday level of the Index from the previous Index Business Day's Index Closing Level may cause a significant variation between the closing Indicative Note Value and the Intraday Indicative Value on any date of determination. The Intraday Indicative Value also does not reflect intraday changes in the leverage; it is based on the constant Daily Leverage Factor of 2. Consequently, the Intraday Indicative Value may vary significantly from the previous or next Index Business Day's closing Indicative Note Value or the price of the notes purchased intraday. See "Risk Factors — The notes are subject to intraday purchase risk," "— The Indicative Note Value is reset daily, and the leverage of the notes during any given Index Business Day may be greater or less than -2.0" and "— The notes are subject to intraday purchase risk." The Intraday Indicative Value for the notes will be published every 15 seconds on Bloomberg under the ticker symbol indicated herein.

Trading Price. The market value of the notes at any given time, which we refer to as the trading price, is the price at which you may be able to buy or sell your notes in the secondary market, if one exists. The trading price may vary significantly from the Intraday Indicative Value, because the market value reflects investor supply and demand for the notes.

Redemption Amount. The Redemption Amount is the price per note that we will pay you to redeem the notes upon your request. The Redemption Amount is calculated according to the formula set forth above. The Redemption Amount may vary significantly from the Intraday Indicative Value and the trading price of the notes.

Because the Redemption Amount is based on the Index Closing Level at the end of the Index Business Day after a notice of redemption is received, you will not know the Redemption Amount you will receive at the time you elect to request that we redeem your notes.

Ticker Symbols

Trading price:	FNGZ
Intraday indicative value:	FNGZIV
Intraday Index value:	NYFANGT<Index>

Selected Risk Considerations

An investment in the notes involves risks. Selected risks are summarized here, but we urge you to read the more detailed explanation of risks described under "Risk Factors" beginning on page PS-12.

- **You may lose some or all of your principal** — The notes do not guarantee any return on your initial investment. The notes are leveraged inverse notes, which means they are exposed to two times the risk of any increase in the level of the Index, compounded daily. Due to leverage, the notes are very sensitive to changes in the level of the Index and the path of such changes. Because the Daily Investor Fee and any negative Daily Interest reduce your final payment, the level of the Index, measured as a component of the closing Indicative Note Value during the Final Measurement Period or Call Measurement Period, or on a Redemption Measurement Date, will need to decrease by an amount at least equal to the percentage of the Principal Amount represented by the Daily Investor Fee, any negative Daily Interest and Redemption Fee Amount, if applicable, in order for you to receive an aggregate amount at maturity, upon a call or redemption, or if you sell your notes, that is equal to at least the Principal Amount. If the decrease in the level of the Index during the Final Measurement Period or Call Measurement Period, or on a Redemption Measurement Date, is insufficient to offset the cumulative negative effect of the Daily Investor Fee, any negative Daily Interest and the Redemption Fee Amount, if applicable, you will lose some or all of your investment at maturity or call, or upon early redemption. This loss may occur even if the Index Closing Levels during the Final Measurement Period or Call Measurement Period, on a Redemption Measurement Date, or when you elect to sell your notes, are less than the Initial Index Level.

- **The Daily Interest may be negative** — Although the Daily Interest will be added to the Deposit Amount, the Daily Interest will be negative on any Exchange Business Day on which the Daily Interest Rate is negative. On those Exchange Business Days, the Daily Interest will be subtracted from the Deposit Amount, which, in turn, will reduce the Indicative Note Value and the amount that you will receive for your notes at maturity, call or redemption.

- **Correlation and compounding risk** — A number of factors may affect the notes' ability to achieve a high degree of correlation with the performance of the Index, and there is a significant possibility that the notes will not achieve a high degree of correlation with the performance of the Index over periods longer than one day. The leverage is reset daily, the return on the notes is path dependent and you will be exposed to compounding of daily returns. As a result, the performance of the notes for periods greater than one Index Business Day may be either greater than or less than two times the inverse of the Index performance, before accounting for the Daily Investor Fee, any negative Daily Interest and any Redemption Fee Amount. Further, significant adverse performances of the notes may not be offset by subsequent beneficial performances of equal magnitude.

- **Daily reset** — Because the leverage of the notes is generally only reset once each day, it is likely that due to intra-day changes in the level of the Index, the leverage at any point during an Index Business Day can be higher or lower than the target leverage, which is -2.0.

Path dependence — The return on the notes will be highly path dependent. Accordingly, even if the level of the Index decreases or increases over the term of the notes, or over the term which you hold the notes, the value of the notes will increase or decrease not only based on any change in the level of the Index over a given time period but also based on the volatility of the Index over that time period. The value of the notes will depend not only upon the level of the Index at maturity, upon call or upon early redemption, but also on the performance of the Index over each day that you hold the notes. It is possible that you will suffer significant losses in the notes, even if the long-term performance of the Index is negative. Accordingly, the returns on the notes may not correlate with returns on the Index over periods of longer than one day.

Long holding period risk — The notes are intended to be daily trading tools for sophisticated investors and are designed to reflect a leveraged inverse exposure to the performance of the Index on a daily basis, but their returns over different periods of time can, and most likely will, differ significantly from two times the return on a direct inverse investment in the Index. The notes are very sensitive to changes in the level of the Index, and returns on the notes may be negatively affected in complex ways by volatility of the Index on a daily or intraday basis. Also, the Index is potentially volatile as it includes only a small number of constituents (10, as of the date of this pricing supplement); any Index volatility would be magnified by the leverage. Accordingly, the notes should be purchased by knowledgeable investors who understand the potential consequences of investing in the Index and of seeking daily compounding leveraged inverse investment results. Investors should actively and frequently monitor their investments in the notes, even intra-day. **It is possible that you will suffer significant losses in the notes even if the long-term performance of the Index is negative (before taking into account the negative effect of the Daily Investor Fee and any negative Daily Interest, and the Redemption Fee Amount, if applicable).**

- **Potential total loss of value** — If the closing Indicative Note Value of the notes is equal to or less than $0 on any Exchange Business Day, then the Indicative Note Value on all future Exchange Business Days will be $0. If the Intraday Indicative Value of the notes is equal to or less than $0 at any time on any Index Business Day, then both the Intraday Indicative Value of the notes and the closing Indicative Note Value on that Exchange Business Day, and on all future Exchange Business Days, will be $0. ***If the Indicative Note Value is zero, the Cash Settlement Amount will be zero.***

- **Leverage risk —** The notes are two times leveraged and, as a result, the notes will benefit from two times any negative, but will decline based on two times any positive, daily performance of the Index. However, the leverage of the notes may be greater or less than -2.0 during any given Index Business Day if the level of the Index on any Exchange Business Day has increased or decreased from the Index Closing Level on the preceding Index Business Day. Volatility of the Index level may have a significant negative effect on the value of the notes.

- **Market risk** — The return on the notes, which may be positive or negative, is linked to a two times leveraged participation in the inverse performance of the Index, compounded daily, as measured by the Index Performance Factor, and which, in turn, is affected by a variety of market and economic factors affecting the Index constituents, such as interest rates in the markets and economic, financial, political, regulatory, judicial or other events that affect the markets generally.

- **Credit of issuer** — The notes are senior unsecured debt obligations of the issuer, Bank of Montreal, and are not, either directly or indirectly, an obligation of any third party. Any payment to be made on the notes, including any payment at maturity, call or upon early redemption, depends on the ability of Bank of Montreal to satisfy its obligations as they come due. As a result, the actual and perceived creditworthiness of Bank of Montreal will affect the market value, if any, of the notes prior to maturity, call or early redemption. In addition, in the event Bank of Montreal was to default on its obligations, you may not receive any amounts owed to you under the terms of the notes.

- **The Index has a limited actual performance history** — The Index was launched on September 26, 2017. Because the Index is of recent origin and limited actual historical performance data exists with respect to it, your investment in the notes may involve a greater risk than investing in securities linked to one or more indices with a more established record of performance.

- **The Index lacks diversification and is concentrated in two sectors, and has a limited number of Index constituents —** All of the stocks included in the Index are issued by companies whose primary lines of business are in the technology and consumer discretionary sectors. As a result, the notes will not benefit from the diversification that could result from an investment linked to an index of companies that operate in multiple sectors. Each of the Index constituents represents 10% of the weight of the Index as of each quarterly rebalancing date (based on the current 10 Index constituents). Any increase in the market price of any of those stocks is likely to have a substantial positive impact on the Index Closing Level and a substantial adverse impact on the value of the notes. Giving effect to leverage, positive changes in the performance of one Index constituent will be magnified and have a material adverse effect on the value of the notes.

A trading market for the notes may not develop — Although the notes have been listed on the NYSE, subject to official notice of issuance, a trading market for the notes may not develop. Certain of our affiliates may engage in limited purchase and resale transactions in the notes, although they are not required to and may stop at any time. We are not required to maintain any listing of the notes on the NYSE or any other exchange. In addition, we are not obliged to, and may not, sell the full aggregate principal amount of the notes. We may suspend or cease sales of the notes at any time, at our discretion. Therefore, the liquidity of the notes may be limited.

The Intraday Indicative Value is not the same as the trading price of the notes in the secondary market — The Intraday Indicative Value of the notes will be calculated by ICE Data Indices, LLC ("ICE Data") and published every 15 seconds on each Exchange Business Day during normal trading hours on Bloomberg under the ticker symbol FNGZIV so long as no Market Disruption Event has occurred or is continuing and will be disseminated over the consolidated tape, or other major market vendor. The Intraday Indicative Value calculation uses, for the Intraday Index Performance Factor, the intraday Index level as of the time of calculation, which could adversely affect the value of the notes. The Intraday Indicative Value also does not reflect intraday changes in the leverage. See "Intraday Value of the Index and the Notes — Intraday Indicative Note Values." The trading price of the notes at any time is the price at which you may be able to sell your notes in the secondary market at such time, if one exists. The trading price of the notes at any time may vary significantly from the Intraday Indicative Value of the notes at such time.

- **Paying a premium purchase price over the Intraday Indicative Value of the notes could lead to significant losses in the event one sells such notes at a time when such premium is no longer present in the market place or the notes are called** — Paying a premium purchase price over the Intraday Indicative Value of the notes could lead to significant losses in the event one sells the notes at a time when such premium is no longer present in the market place or if the notes are called, in which case investors will receive a cash payment in an amount based on the arithmetic mean of the closing Indicative Note Value of the notes on each Index Business Day during the Call Measurement Period. We may, without providing you notice or obtaining your consent, create and issue notes in addition to those offered by this pricing supplement having the same terms and conditions as the notes. However, we are under no obligation to sell additional notes at any time, and we may suspend issuance of new notes at any time and for any reason without providing you notice or obtaining your consent. If we limit, restrict or stop sales of additional notes, or if we subsequently resume sales of such additional notes, the price and liquidity of the notes could be materially and adversely affected, including an increase or decline in the premium purchase price of the notes over the Intraday Indicative Value. Before trading in the secondary market, you should compare the Intraday Indicative Value with the then-prevailing trading price of the notes.

- **Potential conflicts —** We and our affiliates play a variety of roles in connection with the issuance of the notes, including acting as an agent of the issuer for the offering of the notes, making certain calculations and determinations that may affect the value of the notes and hedging our obligations under the notes. Any profit in connection with such hedging activities will be in addition to any other compensation that we and our affiliates receive for the sale of the notes, which creates an additional incentive to sell the notes to you. Our affiliates will, among other things, calculate the arithmetic mean of the closing Indicative Note Values and the Redemption Fee Amount, where applicable, make determinations with respect to Market Disruption Events, splits and reverse splits of the notes and the replacement of the Index with a successor index. Any exercise by us of our Call Right could present a conflict between your interest in the notes and our interests in determining whether to call the notes. We have no obligation to ensure that investors will not lose all or a portion of their investment in the notes upon a call. In performing these activities, our economic interests and those of our affiliates are potentially adverse to your interests as an investor in the notes.

- **Call right** — We may elect to redeem all outstanding notes at any time on or after February 6, 2019, as described under "Specific Terms of the Notes — Call Right." If we exercise our Call Right, the Call Settlement Amount may be less than the Principal Amount of your notes.

- **Minimum redemption amount** — You must elect to redeem at least 25,000 notes for us to repurchase your notes, unless we determine otherwise or your broker or other financial intermediary bundles your notes for redemption with those of other investors to reach this minimum requirement, and there can be no assurance that they can or will do so. Therefore, the liquidity of the notes may be limited.

- **Your redemption election is irrevocable** — You will not be able to rescind your election to redeem your notes after your redemption notice is received by us. Accordingly, you will be exposed to market risk if the level of the Index decreases after we receive your offer and the Redemption Amount is determined on the Redemption Measurement Date. You will not know the Redemption Amount at the time that you submit your irrevocable redemption notice.

- **Owning the notes is not the same as owning any of the Index constituents** — The return on the notes may not reflect the return you would realize if you actually owned any of the Index constituents.

- **Uncertain tax treatment** — Significant aspects of the tax treatment of the notes are uncertain. You should consult your own tax advisor about your own tax situation.

The notes may be a suitable investment for you if:

· You seek a short-term investment with a return linked to a two times leveraged participation in the inverse performance of the Index, compounded daily, in which case you are willing to accept the risk of fluctuations in the technology and consumer discretionary sectors.

· You understand (i) leverage risk, including the risks inherent in maintaining a constant two times daily inverse leverage, and (ii) the consequences of seeking leveraged investment results generally.

· You believe the level of the Index will decrease during the term of the notes by an amount, after giving effect to the daily leverage and the compounding effect thereof, sufficient to offset the Daily Investor Fee, any negative Daily Interest and any Redemption Fee Amount.

· You are a sophisticated investor, understand path dependence of investment returns and you seek a short-term investment in order to manage daily trading risks.

· You understand that the notes are designed to achieve their stated investment objective on a daily basis, but their performance over different periods of time can differ significantly from their stated daily objective.

· You are willing to accept the risk that you may lose some or all of your investment.

· You are willing to hold securities that may be redeemed early by us, under our call right, on or after February 6, 2019.

· You are willing to forgo dividends or other distributions paid to holders of the Index constituents, except as reflected in the level of the Index, and are willing to hold securities that may be negatively affected by dividends or other distributions paid to holders of the Index constituents to the extent they are reflected in the level of the Index.

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Accounts payable	**(58,391)**	82,021
Accrued expenses	**-**	1,242
Net cash (used in) operating activities	**(163,895)**	(54,579)
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of capital assets	**(3,200)**	(3,057)
Net cash (used in) investing activities	**(3,200)**	(3,057)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances from related parties	**89,763**	61,475
Proceeds from sale of warrants to purchase common stock	**80,000**	

		-
Net cash provided from financing activities	**169,763**	61,475
NET INCREASE IN CASH	**2,668**	3,839
CASH, BEGINNING OF PERIOD	**1,148**	2,794
CASH, END OF PERIOD	**$ 3,816**	$ 6,633

SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	**$ -**	$ -
Taxes paid	**-**	-

See notes to consolidated financial statements.

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ELEMENT 21 GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
September 30, 2005
(Unaudited)

NOTE 1 NATURE OF BUSINESS AND OPERATIONS:

Element 21 Golf Company and subsidiaries (a development stage enterprise) (the "Company" and or "Element 21") designs, develops and has begun to market, Scandium alloy golf products. The first products manufactured using the Company's proprietary technology have been recently produced and the Company commenced distribution to wholesalers and retail markets during the last quarter of it's fiscal year ended June 30, 2005.

The Company is subject to a number of risks similar to those of other companies in the early stages of operations. Principal among these risks are dependencies on key individuals, competition from other current or substitute products and larger companies, the successful marketing of its products and the need to obtain adequate financing necessary to fund future operations. Certain consultants, who are also stockholders of the Company, have advanced funds to allow the Company to acquire aluminum Scandium alloy concentrate from Russia and to acquire critical lateral forging equipment made in the U.S., both of which were shipped to South Korea to enable the production of Scandium alloy golf shafts.

The accompanying unaudited consolidated condensed financial statements have been prepared from the books and records of Element 21 on the same basis as the annual financial statements and are consistent with the instructions to Form 10-QSB and Rule 310 of Regulation S-B. Accordingly, the accompanying financial statements do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending June 30, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report for the year ended June 30, 2005.

NOTE 2 FUTURE OPERATIONS/GOING CONCERN:

These interim financial statements have been presented on the basis that the Company is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has only recently begun producing revenues however, not on any consistent basis. Even with the generation of revenues from the sale of golf shafts now being produced and sold, the Company expects to incur expenses in excess of revenues for an indefinite period.

Key financial information follows:

		September 30, 2005		June 30, 2005
Negative working capital	**$**	**756,399**	$	744,539
Net loss		**958,746**		1,352,931
Accumulated deficit		**13,675,227**		12,716,481

As shown in the accompanying financial statements, during the three months ended September 30, 2005 the Company incurred a net loss of $958,746 and cash utilized by operations during this period was $163,895. For the fiscal year ended June 30, 2005, the Company realized a net loss of $1,352,931 and utilized cash of $414,754 for operating purposes.

These factors, among others, raise significant doubt about the Company's ability to continue as a going concern. The unaudited consolidated condensed financial statements do not include any adjustments relating to the recoverability and

ELEMENT 21 GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
September 30, 2005
(Unaudited)

NOTE 2 FUTURE OPERATIONS/GOING CONCERN (CONTINUED):

classification of assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flow and meet its obligations on a timely basis and ultimately attain profitability. Since acquiring the Element 21 Technologies golf development business, the Company has depended on advances and consulting services from consultants engaged by the Company. Absent these continuing advances and services, the Company could not continue with the development and marketing of its golf products.

Managements' plans for the Company include more aggressive marketing, raising additional capital and other strategies designed to optimize shareholder value. However, no assurance can be given that management will be successful in fulfilling all components of its plan. The failure to achieve these plans will have a material adverse effect on the Company's financial position, results of operations and ability to continue as a going concern.

During the three months ended September 30, 2005 the Company issued 11,281,265 shares of its common stock to consultants for services rendered by them and recorded an expense of $779,539. The Company also sold warrants to purchase one million shares of its common stock at a price of $0.08 per warrant, realizing proceeds of $80,000. The exercise price for shares purchased under this warrant is $.15 per share.

NOTE 3 RELATED PARTY ADVANCES:

During the three month period ended September 30, 2005, certain related parties advanced to the Company a total of $89,763. These advances are recorded as an increase in loans and are not expected to be repaid during the next twelve months..

NOTE 4 NET LOSS PER SHARE:

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the periods. Diluted net loss per share reflects, in addition to the weighted average number of common shares, the potential dilution of stock options and warrants outstanding, exercised and/or converted into common stock, unless the effect of such equivalent shares was anti-dilutive.

For the three months ended September 30, 2005 and 2004, the effect of stock options and other potentially dilutive shares were excluded from the calculation of diluted net loss per common shares, as their inclusion would have been anti-dilutive. Therefore diluted loss per share is equal to basic loss per share.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Cautionary Statement Regarding Forward-Looking Information

Under the Private Securities Litigation Reform Act of 1995, companies are provided with a “safe harbor” for making forward-looking statements about the potential risks and rewards of their strategies. Forward-looking statements often include the words “believe”, “expect”, “anticipate”, “intend”, “plan”, “estimate” or similar expressions. In this Form 10-(forward-looking statements also include:

- statements about our business plans;
- statements about the potential for the development, regulatory approval and public acceptance of new services;
- estimates of future financial performance;
- predictions of national or international economic, political or market conditions;
- statements regarding other factors that could affect our future operations or financial position; and
- other statements that are not matters of historical fact.

These statements may be found under “Management’s Discussion and Analysis or Plan of Operation” as well as in this Form 10-QSB generally. Our ability to achieve our goals depends on many known and unknown risks and uncertainties, including changes in general economic and business conditions. These factors could cause our actual performance and results to differ materially from those described or implied in forward-looking statements.

These forward looking statements speak only as of the date of this Form 10-QSB. We believe it is in the best interest of our investors to use forward-looking statements in discussing future events. However, we are not required to, and you should not rely on us to, revise or update these statements or any factors that may materially affect actual results, whether as a result of new information, future events or otherwise. You should carefully review the risk factors described in this Form 10-QSB and also review the other documents we file from time to time with the Securities and Exchange Commission (“SEC”).

Results of Operations

Three Months Ended September 30, 2005 and 2004

For the three months ended September 30, 2005 the Company, had revenue of $22,620 and incurred costs of sales of $12,074 and general and administrative expenses of $969,292. Included in general and administrative expenses is a non-cash charge of $779,539, representing the value of common shares issued for services provided by consultants. This resulted in a net loss of $958,746, as compared with the three months ended September 30, 2004 in which the Company had no revenues and general and administrative expenses of $425,918, resulting in a net loss also of $425,918. The primary reason for the higher amount of general and administrative expenses during the three months ending September 30, 2005 is due to expenditures incurred in the marketing of our product.

Financial Condition, Liquidity and Capital Resources

The Company has negative working capital as of September 30, 2005 of $756,399. The Company retains consultants who are also significant stockholders of the Company to perform development and public company reporting activities in exchange for stock of the Company. At June 30, 2005, we had a working capital deficiency of $744,539. Our continuation as a going concern will require that we raise significant additional capital.

Absent continued issuance of common stock for services by these consultants and continued advances by stockholders of the Company, the Company cannot manufacture its golf shaft product line or market golf products based on its technologies. The Company is actively searching for capital to implement its business plans, supply the Company with products for distribution, and develop collateral materials for its potential customer base. There can be no assurance such capital will be raised on terms acceptable to the Company and if this capital is raised, it, may cause significant dilution to the Company's stockholders.

Dividend Policy

The Company has not declared or paid any cash dividends on its common stock since its inception and does not anticipate the declaration or payment of cash dividends in the foreseeable future. The Company intends to retain earnings, if any, to finance the development and expansion of its business. The Company's future dividend policy will be subject to the discretion of the Board of Directors and will be contingent upon future earnings, if any, the Company's financial condition, capital requirements, general business conditions and other factors. Therefore, there can be no assurance that dividends of any kind will ever be paid.

Effect of Inflation

Management believes that inflation has not had a material effect on its operations for the periods presented.

Risk Factors

We Have A Limited Operating History And A History Of Substantial Operating Losses.

We have a history of substantial operating losses and an accumulated deficit of $13,675,227 as of September 30, 2005. We have historically experienced cash flow difficulties primarily because our expenses have exceeded our revenues. We expect to incur additional operating losses. These factors, among others, raise significant doubt about our ability to continue as a going concern. If we are unable to generate sufficient revenue from our operations to pay expenses or we are unable to obtain additional financing on commercially reasonable terms, our business, financial condition and results of operations will be materially and adversely affected.

We Will Need Additional Financing In Order to Continue Our Operations Which We May Not Be Able to Raise.

We will require additional capital to finance our future operations. We can provide no assurance that we will obtain additional financing sufficient to meet our future needs on commercially reasonable terms or otherwise. If we are unable to obtain the necessary financing, our business, operating results and financial condition will be materially and adversely affected.

We Have No Employees and Our Success Is Dependent On Our Ability to Retain And Attract Consultants to Operate Our Business and There Is No Assurance That We Can Do So.

As of September 30, 2005, we have no employees and utilize the services of consultants. Nataliya Hearn, PhD, who is also our CEO and President based in Toronto, Canada, oversees the Company's engineering, alloy supply and production. Jim Morin, who is also our Vice-President, Secretary and Treasurer, and Frank Gojny, both of whom are based in California, oversee the development, testing and United States Golf Association compliance for golf products.

The Duran Group was added in December 2004 to consult on the sales and marketing of the Company. Our future success will depend in large part upon our ability to attract and retain highly skilled technical, managerial, sales and marketing personnel and consultants. There is significant competition for such personnel in our industry. There can be no assurance that we will continue to be successful in attracting and retaining the consultants and/or personnel we require to develop new and enhanced technologies and to grow and operate profitably.

Our Performance Depends On Market Acceptance Of Our Products and We Cannot Be Sure That Our Products Are Commercially Viable.

We expect to derive a substantial portion of our future revenues from the sales of Scandium alloy golf shafts that are only now entering the initial marketing phase. Although we believe our products and technologies will be commercially viable, these are new and untested products. If markets for our products fail to develop, develop more slowly than expected or are subject to substantial competition, our business, financial condition and results of operations will be materially and adversely affected.

We Depend On Strategic Marketing Relationships and If We Fail to Maintain or Establish Them, Our Business Plan May Not Succeed.

We expect our future marketing efforts will focus in part on developing business relationships with distributors that will market our products to their customers. The success of our business depends on selling our products and technologies to a large number of distributors and retail customers. Our inability to enter into and retain strategic relationships, or the inability to effectively market our products, could materially and adversely affect our business, operating results and financial condition.

Competition From Traditional Golf Equipment Providers May Increase And We May Not Be Able to Adequately Compete.

The market for golf shafts is highly competitive. There are a number of other established providers that have greater resources, including more extensive research and development, marketing and capital than we do and also have greater name recognition and market presence. These competitors could reduce their prices and thereby decrease the demand for our products and technologies. These competitors may lower their prices to compete with us. We expect competition to intensify in the future, which could also result in price reductions, fewer customer and lower gross margins.

Rapidly Changing Technology And Substantial Competition May Adversely Affect Our Business.

Our business is subject to rapid changes in technology. We can provide no assurances that research and development by competitors will not render our technology obsolete or uncompetitive. We compete with a number of companies that have technologies and products similar to those offered by us and have greater resources, including more extensive research and development, marketing and capital than we do. We can provide no assurances that we will be successful in marketing our existing products and developing and marketing new products in such a manner as to be effective against our competition. If our technology is rendered obsolete or we are unable to compete effectively, our business, operating results and financial condition will be materially and adversely affected.

Litigation Concerning Intellectual Property Could Adversely Affect Our Business.

We rely on a combination of trade secrets, trademark law, contractual provisions, confidentiality agreements and certain technology and security measures to protect our trademarks, license, proprietary technology and know-how. However, we can provide no assurance that competitors will not infringe upon our rights in our intellectual property or that competitors will not similarly make claims against us for infringement. If we are required to be involved in litigation involving intellectual property rights, our business, operating results and financial condition will be materially and adversely affected.

It is possible that third parties might claim infringement by us with respect to past, current or future technologies. We expect that participants in our markets will increasingly be subject to infringement claims as the number of services and competitors in our industry grows. Any claims, whether meritorious or not, could be time-consuming, result in costly litigation and could cause service upgrade delays or require us to enter into royalty or licensing agreements. These royalty or licensing agreements might not be available on commercially reasonable terms or at all.

Defects In Our Products May Adversely Affect Our Business.

Complex technologies such as the technologies developed by us may contain defects when introduced and also when updates and new products are released. Our introduction of technology with defects or quality problems may result in adverse publicity, product returns, reduced orders, uncollectible or delayed accounts receivable, product redevelopment costs, loss of or delay in market acceptance of our products or claims by customers or others against us. Such problems or claims may have a material and adverse effect on our business, financial condition and results of operations.

ITEM 3 CONTROLS AND PROCEDURES:

(a) Evaluation of disclosure controls and procedures. Management, including our Chief Executive Officer and Principal Financial Officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, our Chief Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective to provide a reasonable level of assurance that the information required to be disclosed in the reports filed or submitted by us under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the requisite time periods.

(b) Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1 LEGAL PROCEEDINGS

None

Item 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three months ended September 30, 2005 the Company issued 11,281,265 shares of its common stock to consultants for services rendered by them and recorded an expense of $779,539. The Company also sold warrants to purchase one million shares of its common stock at a price of $0.08 per warrant, realizing proceeds of $80,000. The exercise price for shares purchased under this warrant is $.15 per share. The shares and warrants were issued in reliance on exemptions from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

Item 3 DEFAULT UPON SENIOR SECURITIES

None

Item 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Item 5 OTHER INFORMATION

None

Item 6 EXHIBITS

Exhibit No.	Exhibit Description
31.1	Certification Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification Pursuant to Section 302 of the Sarbanes Oxley Act of 2002

32.1	Certification Pursuant to Section 906 of the Sarbanes Oxley Act of 2002

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Element 21 Golf Company

November 18, 2005 By: /s/ Nataliya Hearn

Nataliya Hearn, Ph.D.
President and Director

November 18, 2005 By: /s/ Jim Morin

Secretary, Treasurer,
CFO and Director

Name: PageNo -->22

Risks Relating to the Index

The Index has limited actual historical information.

The Index was launched on September 26, 2017. Because the Index is of recent origin and limited actual historical performance data exists with respect to it, your investment in the notes may involve a greater risk than investing in securities linked to an Index with a more established record of performance.

The historical performance of the Index should not be taken as an indication of its future performance. While the trading prices of the Index constituents will determine the Index level, it is impossible to predict whether the Index level will fall or rise. Trading prices of the Index constituents will be influenced by the complex and interrelated economic, financial, regulatory, geographic, judicial, tax, political and other factors that can affect the capital markets generally and the equity trading markets on which the Index constituents are traded, and by various circumstances that can influence the prices of the Index constituents. Due to the small number of Index constituents, the level of the Index may be materially affected by changes in the level of a small number of Index constituents, or even one Index constituent.

ICE Data Indices, LLC, as the Index Calculation Agent, may adjust the Index in a way that may affect its level, and the Index Calculation Agent has no obligation to consider your interests.

ICE Data Indices, LLC, as the Index Calculation Agent, Index Sponsor and Index Administrator, is responsible for calculating and maintaining the Index. The Index Sponsor can add, delete or substitute an Index constituent or make other methodological changes that could change the Index level. The Index Sponsor will determine, for example, which companies have an appropriate business for inclusion in the Index. Changes to the Index constituents may affect the Index, as a newly added equity security may perform significantly better or worse than the Index constituent or constituents it replaces. Additionally, the Index Sponsor may alter, discontinue or suspend calculation or dissemination of the Index. Any of these actions could adversely affect the value of the notes. As Index Calculation Agent, Index Sponsor and Index Administrator, ICE Data Indices, LLC has no obligation to consider your interests in calculating or revising the Index. See “The Index.”

As discussed above, the Index was launched recently. The Index Sponsor has indicated that it expects to monitor the composition of the Index over time, including through discussions with market participants, in order to determine whether any changes to the Index or its components are necessary or appropriate. Because the Index currently has only 10 components, any additions to or deletions from the Index could have a significant impact on future levels of the Index.

We and our affiliates have no affiliation with ICE Data Indices, LLC and are not responsible for any of their public disclosure of information.

We and our affiliates are not affiliated with ICE Data Indices, LLC, as the Index Calculation Agent, Index Sponsor and Index Administrator (except for licensing arrangements discussed under "The Index — License Agreement") and have no ability to control or predict its actions, including any errors in or discontinuation of public disclosure regarding methods or policies relating to the calculation of the Index. If the Index Sponsor discontinues or suspends the calculation of the Index, it may become difficult to determine the market value of the notes and the payment at maturity, call or upon early redemption. The Calculation Agent may designate a successor index in its sole discretion. If the Calculation Agent determines in its sole discretion that no successor index comparable to the Index exists, the payment you receive at maturity, call or upon early redemption will be determined by the Calculation Agent in its sole discretion. See "Specific Terms of the Notes — Market Disruption Events" and "— Calculation Agent." The Index Sponsor is not involved in the offer of the notes in any way and has no obligation to consider your interest as an owner of the notes in taking any actions that might affect the market value of your notes.

ICE Data Indices, LLC, as the Index Calculation Agent, Index Sponsor and Index Administrator is not involved in the offering of the notes in any way and it does not have any obligation of any sort with respect to your notes. We are not affiliated with ICE Data Indices, LLC, as Index Calculation Agent, Index Sponsor and Index Administrator and it does not have any obligation to take your interests into consideration for any reason, including when taking any actions that might affect the value of the notes.

We have derived the information about ICE Data Indices, LLC and the Index from publicly available information, without independent verification. Neither we nor any of our affiliates have undertaken any independent review of the publicly available information about ICE Data Indices, LLC, as the Index Calculation Agent, Index Sponsor and Index Administrator or the Index contained in this pricing supplement. You, as an investor in the notes, ***should make your own independent investigation into the ICE Data Indices, LLC, as the Index Calculation Agent, Index Sponsor and Index Administrator and the Index.***

The Index Calculation Agent may, in its sole discretion, discontinue the public disclosure of the intraday Index value and the end-of-day closing value of the Index.

The Index Calculation Agent is under no obligation to continue to calculate the intraday Index value and end-of-day official closing value of the Index, or to calculate similar values for any successor index. If the Index Calculation Agent discontinues such public disclosure, we may not be able to provide the Intraday Indicative Values related to the Index or the Intraday Indicative Value of the notes.

The Index lacks diversification and is vulnerable to fluctuations in the technology and consumer discretionary industries.

All of the stocks included in the Index are issued by companies whose primary lines of business are in the technology and consumer discretionary industries. As a result, the stocks that will determine the performance of the Index and hence, the value of the notes, are concentrated in two industries and vulnerable to events affecting those industries. Although an investment in the notes will not give holders any ownership or other direct interests in the Index constituents, the return on an investment in the notes will be subject to certain factors, including those described below, associated with a short equity investment in companies in the technology and consumer discretionary industries. Accordingly, by investing in the notes, you will not benefit from the diversification which could result from an investment linked to companies that operate in multiple sectors. The Index is also subject to the risk that large-capitalization stocks may outperform other segments of the equity market or the equity market as a whole. Larger, more established companies may be better able to respond quickly to new competitive challenges such as changes in technology and may be less likely to encounter challenges faced by smaller companies, including during extended periods of economic contraction. Additionally, technology and consumer discretionary stocks generally, and certain of the index constituents specifically, have previously experienced periods of prolonged price appreciation as well as market volatility. Such performance, if it occurred in the future, would be expected to negatively affect the value of the notes. Moreover, using a proprietary methodology discussed below, the Index specifically seeks to identify constituent issuers that exhibit characteristics of high-growth technology and internet/media stocks, which may negatively affect the value of the notes. Past performance is not indicative of future results.

A limited number of Index constituents may affect the Index Closing Level, and the Index is not necessarily representative of its focus industry.

Each of the Index constituents represents 10% of the weight of the Index as of each quarterly rebalancing date (based on the 10 Index constituents as of the date of this pricing supplement). Any increase in the market price of any of those stocks is likely to have a substantial adverse impact on the Index Closing Level and the value of the notes. Due to the small number of Index constituents, those Index constituents and the Index itself may not necessarily follow the price movements of the entire technology and consumer discretionary industries. If the Index constituents increase in value, the Index will also increase in value, even if common stock prices of other companies in the technology and consumer discretionary industries generally decrease in value. Giving effect to leverage, positive changes in the performance of one Index constituent will be magnified and have a material adverse effect on the value of the notes. See "Summary—Path Dependence and Daily Leverage Reset" above.

An Index constituent may be replaced upon the occurrence of certain adverse events.

An exchange may delist an Index constituent. Procedures have been established by the Index Sponsor to address such an event. Because there are only 10 Index constituents as of the date of this pricing supplement, there can be no assurance that the replacement or delisting of the Index constituents, or any other force majeure event, will not have an adverse or distortive effect on the Index level or the manner in which it is calculated and, therefore, may have any adverse impact on the value of the notes. An Index constituent may also be removed from the Index, as described under "The Index — Index Maintenance."

The Index uses a proprietary selection methodology, which may not select the constituent issuers in the same manner as would other index providers or market participants.

Using a proprietary methodology discussed below, the Index seeks to identify constituent issuers that exhibit characteristics of high-growth technology and Internet/media stocks. When selecting future constituent issuers, the Index Sponsor will focus on distinguishing between traditional technology and service companies and newer, innovative, technology-utilizing companies. The Index Sponsor's methodology, to some extent, involves subjective judgments, and there can be no assurance that any or all constituent issuers included in the Index would be selected by other market participants using a similar selection process. See "The Index—Index Constituent Selection."

We are not currently affiliated with any of the constituent issuers.

We are not currently affiliated with any of the constituent issuers. As a result, we have no ability, nor expect to have the ability in the future, to control the actions of such constituent issuers, including actions that could affect the value of the Index constituents or the value of your notes, and we are not responsible for any disclosure made by any other company. None of the money you pay us will go to any of the constituent issuers represented in the Index and none of the constituent issuers will be involved in the offering of the notes in any way. The constituent issuers will not have any obligation to consider your interests as a holder of the notes in taking any corporate actions that might affect the value of your notes.

In the event we become affiliated with any of the constituent issuers, we will have no obligation to consider your interests as a holder of the notes in taking any action with respect to such constituent issuer that might affect the value of your notes.

HYPOTHETICAL EXAMPLES

Hypothetical Payment at Maturity

The following examples and table illustrate how the notes would perform at maturity in hypothetical circumstances, and are intended to highlight how the return on the notes is affected by the daily performance of the Index, fees, leverage, compounding and path dependency. For ease of review, hypothetical examples 1-5 cover a 22-day period.

We have included examples in which the Index level alternatively decreases and increases at a constant rate of 3.00% per day, with the Index level dropping by one point by day 22 (Example 1) and a Note Return of -4.12%, and an example in which the Index level increases at a constant rate of 3.00% per day, increasing 91.61 points by day 22 (Example 2) and a Note Return of -74.43%.

Examples 3-5 highlight the effect of volatility in the Index. In Example 3, the Index level decreases by a constant 1% per day, with a decrease of 19.8 points by day 22 and a Note Return of 54.24%. In contrast, the Index in Example 4, at day 22, has decreased 19.6 points; however, due to the volatility of the Index on a daily basis, the Note Return is -39.38%, a 93.62% difference from the Note Return in Example 3. Example 5 also highlights the effect of volatility in the Index, in that the Index increases and decreases in a volatile manner over the 22-day period, and ends at the same level as on day one. The Note Return is -20.87% even though the Index level is still at 100. For ease of analysis and presentation, examples 1-5 assume that the notes were purchased on the Initial Trade Date at the Indicative Note Value and disposed of on the Maturity Date, no Market Disruption Events occurred and that the term of the notes is 22 days. In Examples 1-5, the Daily Investor Fee and the Daily Interest assume that there are no weekends or holidays; every calendar day is assumed to be an Exchange Business Day. We have not considered a call or early redemption for simplicity.

Table 1 illustrates the effect of two factors that affect the notes' performance: Index volatility and Index return. Index volatility is a statistical measure of the magnitude of fluctuations in the returns of the Index and is calculated as the standard deviation of the natural logarithms of the Index Performance Factor (calculated daily), multiplied by the square root of the number of Exchange Business Days per year (assumed to be 252). Table 1 shows estimated note returns for a number of combinations of Index volatility and Index return over a one-year period. To isolate the impact of daily leveraged exposure, the table assumes no Daily Investor Fees, Daily Interest of zero percent and that the volatility of the Index remains constant over time. If these assumptions were different, the notes' performance would be different than that shown. If the effect of the Daily Investor Fee and the Daily Interest Rate were included, the notes' performance would be different than that shown.

Table 1 is an example in which the notes correspond (before giving effect to the Daily Investor Fee and the Daily Interest) to two times (2x) the daily inverse performance of the Index. The notes might be incorrectly expected to achieve a 20% return on a yearly basis if the Index return was -10%, absent the effects of compounding. However, as Table 1 shows, with an Index volatility of 40%, and given the assumptions listed above, the notes would return -23.61%. In Table 1, shaded areas represent those scenarios where the notes will outperform (i.e., return more than) the inverse Index performance times 2.0 leverage; conversely areas not shaded represent those scenarios where the notes will underperform (i.e., return less than) the inverse Index performance times 2.0 leverage.

These examples and table highlight the impact of the Daily Investor Fee, leverage and compounding on the payment at maturity under different circumstances. Many other factors will affect the value of the notes, and these figures are provided for illustration only. These hypothetical examples and table should not be taken as an indication or a prediction of future Index performance or investment results and are intended to illustrate a few of the possible returns on the notes. Because the Indicative Note Value takes into account the net effect of the Daily Investor Fee, which is a fixed percentage of the value of the note, and the performance of the Index, the Indicative Note Value is dependent on the path taken by the Index level to arrive at its ending level. The figures in these examples and table have been rounded for convenience. Any payment on the notes that you may receive is subject to the credit risk of the Bank of Montreal.

Example 1: The Index level alternatively decreases and increases by a constant 3.00% per day.

Assumptions	
Fee Rate	0.95% per annum
Daily Leverage Factor	2
Daily Deposit Factor	3
Daily Interest Rate	-1.00%
Principal Amount	$50.00
Initial Index Level	100
Note Return	-4.12%
Cumulative Index Return	-0.99%

Day	Index Level	Daily Index Performance	Index Performance Factor	Daily Investor Fee	Fee Accrual	Daily Interest	Deposit Amount	Short Index Amount	Indicative Note Value	Note Return
A	B	C	D	E	F	G	H	I	J	K
	Previous index level * (1+C)		Current Index Level / Previous Index Level	Previous Indicative Note Value * Fee Rate/365	Total of E	Previous Indicative Note Value * Daily Deposit Factor * Daily Interest Rate/365	(Previous Indicative Note Value * Daily Deposit Factor) + G - E	(Previous Indicative Note Value * D * Daily Leverage Factor)	H - I	(Current Indicative Note Value - Previous Indicative Note Value)/ Previous Indicative Note Value
0	100.0						$150.00	$100.00	$50.00	
1	97.0	-3.0%	0.97	$0.0013	$0.0013	-$0.0041	$149.99	$97.00	$52.99	5.99%
2	99.9	3.0%	1.03	$0.0014	$0.0027	-$0.0044	$158.98	$109.17	$49.81	-6.01%
3	96.9	-3.0%	0.97	$0.0013	$0.0040	-$0.0041	$149.42	$96.63	$52.79	5.99%
4	99.8	3.0%	1.03	$0.0014	$0.0054	-$0.0043	$158.37	$108.75	$49.62	-6.01%
5	96.8	-3.0%	0.97	$0.0013	$0.0066	-$0.0041	$148.85	$96.26	$52.59	5.99%
6	99.7	3.0%	1.03	$0.0014	$0.0080	-$0.0043	$157.77	$108.34	$49.43	-6.01%
7	96.7	-3.0%	0.97	$0.0013	$0.0093	-$0.0041	$148.28	$95.89	$52.39	5.99%
8	99.6	3.0%	1.03	$0.0014	$0.0107	-$0.0043	$157.16	$107.92	$49.24	-6.01%
9	96.7	-3.0%	0.97	$0.0013	$0.0119	-$0.0040	$147.72	$95.53	$52.19	5.99%
10	99.6	3.0%	1.03	$0.0014	$0.0133	-$0.0043	$156.56	$107.51	$49.05	-6.01%
11	96.6	-3.0%	0.97	$0.0013	$0.0146	-$0.0040	$147.15	$95.16	$51.99	5.99%
12	99.5	3.0%	1.03	$0.0014	$0.0159	-$0.0043	$155.97	$107.10	$48.87	-6.01%
13	96.5	-3.0%	0.97	$0.0013	$0.0172	-$0.0040	$146.59	$94.80	$51.79	5.99%

14	99.4	3.0%	1.03	$0.0013	$0.0186	-$0.0043	$155.37	$106.69	$48.68	-6.01%
15	96.4	-3.0%	0.97	$0.0013	$0.0198	-$0.0040	$146.03	$94.44	$51.59	5.99%
16	99.3	3.0%	1.03	$0.0013	$0.0212	-$0.0042	$154.78	$106.29	$48.49	-6.01%
17	96.3	-3.0%	0.97	$0.0013	$0.0224	-$0.0040	$145.48	$94.08	$51.40	5.99%
18	99.2	3.0%	1.03	$0.0013	$0.0238	-$0.0042	$154.19	$105.88	$48.31	-6.01%
19	96.2	-3.0%	0.97	$0.0013	$0.0250	-$0.0040	$144.92	$93.72	$51.20	5.99%
20	99.1	3.0%	1.03	$0.0013	$0.0264	-$0.0042	$153.60	$105.48	$48.12	-6.01%
21	96.1	-3.0%	0.97	$0.0013	$0.0276	-$0.0040	$144.37	$93.36	$51.01	5.99%
22	99.0	3.0%	1.03	$0.0013	$0.0289	-$0.0042	$153.01	$105.07	$47.94	-6.01%

Example 2: The Index level increases by a constant 3.00% per day.

Assumptions

Fee Rate	0.95% per annum
Daily Leverage Factor	2
Daily Deposit Factor	3
Daily Interest Rate	-1.00%
Principal Amount	$50.00
Initial Index Level	100
Note Return	-74.43%
Cumulative Index Return	91.61%

Day	Index Level	Daily Index Performance	Index Performance Factor	Daily Investor Fee	Fee Accrual	Daily Interest	Deposit Amount	Short Index Amount	Indicative Note Value	Note Return
A	B	C	D	E	F	G	H	I	J	K
	Previous index level * (1+C)		Current Index Level / Previous Index Level	Previous Indicative Note Value * Fee Rate/365	Total of E	Previous Indicative Note Value * Daily Deposit Factor * Daily Interest Rate/365	(Previous Indicative Note Value * Daily Deposit Factor) + G - E	(Previous Indicative Note Value * D * Daily Leverage Factor)	H - I	(Current Indicative Note Value - Previous Indicative Note Value)/ Previous Indicative Note Value
0	100.0						$150.00	$100.00	$50.00	
1	103.0	3.0%	1.03	$0.0013	$0.0013	-$0.0041	$149.99	$103.00	$46.99	-6.01%
2	106.1	3.0%	1.03	$0.0012	$0.0025	-$0.0039	$140.98	$96.81	$44.17	-6.01%
3	109.3	3.0%	1.03	$0.0011	$0.0037	-$0.0036	$132.50	$90.99	$41.51	-6.01%
4	112.6	3.0%	1.03	$0.0011	$0.0048	-$0.0034	$124.54	$85.52	$39.02	-6.01%
5	115.9	3.0%	1.03	$0.0010	$0.0058	-$0.0032	$117.05	$80.38	$36.67	-6.01%
6	119.4	3.0%	1.03	$0.0010	$0.0067	-$0.0030	$110.02	$75.55	$34.47	-6.01%
7	123.0	3.0%	1.03	$0.0009	$0.0076	-$0.0028	$103.41	$71.01	$32.40	-6.01%
8	126.7	3.0%	1.03	$0.0008	$0.0085	-$0.0027	$97.19	$66.74	$30.45	-6.01%
9	130.5	3.0%	1.03	$0.0008	$0.0093	-$0.0025	$91.35	$62.73	$28.62	-6.01%
10	134.4	3.0%	1.03	$0.0007	$0.0100	-$0.0024	$85.86	$58.96	$26.90	-6.01%
11	138.4	3.0%	1.03	$0.0007	$0.0107	-$0.0022	$80.70	$55.41	$25.28	-6.01%
12	142.6	3.0%	1.03	$0.0007	$0.0114	-$0.0021	$75.85	$52.08	$23.76	-6.01%

13	146.9	3.0%	1.03	$0.0006	$0.0120	-$0.0020	$71.29	$48.95	$22.33	-6.01%
14	151.3	3.0%	1.03	$0.0006	$0.0126	-$0.0018	$67.00	$46.01	$20.99	-6.01%
15	155.8	3.0%	1.03	$0.0005	$0.0131	-$0.0017	$62.97	$43.24	$19.73	-6.01%
16	160.5	3.0%	1.03	$0.0005	$0.0136	-$0.0016	$59.19	$40.64	$18.54	-6.01%
17	165.3	3.0%	1.03	$0.0005	$0.0141	-$0.0015	$55.63	$38.20	$17.43	-6.01%
18	170.2	3.0%	1.03	$0.0005	$0.0146	-$0.0014	$52.29	$35.91	$16.38	-6.01%
19	175.4	3.0%	1.03	$0.0004	$0.0150	-$0.0013	$49.14	$33.75	$15.40	-6.01%
20	180.6	3.0%	1.03	$0.0004	$0.0154	-$0.0013	$46.19	$31.72	$14.47	-6.01%
21	186.0	3.0%	1.03	$0.0004	$0.0158	-$0.0012	$43.41	$29.81	$13.60	-6.01%
22	191.6	3.0%	1.03	$0.0004	$0.0161	-$0.0011	$40.80	$28.02	$12.78	-6.01%

Example 3: The Index level decreases by a constant 1.00% per day.

Assumptions

Fee Rate	0.95% per annum
Daily Leverage Factor	2
Daily Deposit Factor	3
Daily Interest Rate	-1.00%
Principal Amount	$50.00
Initial Index Level	100
Note Return	54.24%
Cumulative Index Return	-19.84%

Day	Index Level	Daily Index Performance	Index Performance Factor	Daily Investor Fee	Fee Accrual	Daily Interest	Deposit Amount	Short Index Amount	Indicative Note Value	Note Return
A	B	C	D	E	F	G	H	I	J	K
	Previous index level * (1+C)		Current Index Level / Previous Index Level	Previous Indicative Note Value * Fee Rate/365	Total of E	Previous Indicative Note Value * Daily Deposit Factor * Daily Interest Rate/365	(Previous Indicative Note Value * Daily Deposit Factor) + G - E	(Previous Indicative Note Value * D * Daily Leverage Factor)	H - I	(Current Indicative Note Value - Previous Indicative Note Value)/ Previous Indicative Note Value
0	100.0						$150.00	$100.00	$50.00	
1	99.0	-1.0%	0.99	$0.0013	$0.0013	-$0.0041	$149.99	$99.00	$50.99	1.99%
2	98.0	-1.0%	0.99	$0.0013	$0.0026	-$0.0042	$152.98	$100.97	$52.01	1.99%
3	97.0	-1.0%	0.99	$0.0014	$0.0040	-$0.0043	$156.02	$102.98	$53.04	1.99%
4	96.1	-1.0%	0.99	$0.0014	$0.0054	-$0.0044	$159.12	$105.03	$54.10	1.99%
5	95.1	-1.0%	0.99	$0.0014	$0.0068	-$0.0044	$162.29	$107.12	$55.17	1.99%
6	94.1	-1.0%	0.99	$0.0014	$0.0082	-$0.0045	$165.52	$109.25	$56.27	1.99%
7	93.2	-1.0%	0.99	$0.0015	$0.0097	-$0.0046	$168.81	$111.42	$57.39	1.99%
8	92.3	-1.0%	0.99	$0.0015	$0.0112	-$0.0047	$172.17	$113.64	$58.53	1.99%
9	91.4	-1.0%	0.99	$0.0015	$0.0127	-$0.0048	$175.59	$115.90	$59.70	1.99%
10	90.4	-1.0%	0.99	$0.0016	$0.0142	-$0.0049	$179.09	$118.20	$60.89	1.99%
11	89.5	-1.0%	0.99	$0.0016	$0.0158	-$0.0050	$182.65	$120.55	$62.10	1.99%
12	88.6	-1.0%	0.99	$0.0016	$0.0174	-$0.0051	$186.28	$122.95	$63.33	1.99%
13	87.8	-1.0%	0.99	$0.0016	$0.0191	-$0.0052	$189.99	$125.40	$64.59	1.99%
14	86.9	-1.0%	0.99	$0.0017	$0.0208	-$0.0053	$193.77	$127.89	$65.88	1.99%

15	86.0	-1.0%	0.99	$0.0017	$0.0225	-$0.0054	$197.62	$130.43	$67.19	1.99%
16	85.1	-1.0%	0.99	$0.0017	$0.0242	-$0.0055	$201.55	$133.03	$68.52	1.99%
17	84.3	-1.0%	0.99	$0.0018	$0.0260	-$0.0056	$205.56	$135.68	$69.89	1.99%
18	83.5	-1.0%	0.99	$0.0018	$0.0278	-$0.0057	$209.65	$138.37	$71.28	1.99%
19	82.6	-1.0%	0.99	$0.0019	$0.0297	-$0.0059	$213.82	$141.13	$72.69	1.99%
20	81.8	-1.0%	0.99	$0.0019	$0.0316	-$0.0060	$218.07	$143.93	$74.14	1.99%
21	81.0	-1.0%	0.99	$0.0019	$0.0335	-$0.0061	$222.41	$146.80	$75.61	1.99%
22	80.2	-1.0%	0.99	$0.0020	$0.0355	-$0.0062	$226.84	$149.72	$77.12	1.99%

Example 4: The Index level decreases in a volatile manner.

Assumptions

Fee Rate	0.95% per annum
Daily Leverage Factor	2
Daily Deposit Factor	3
Daily Interest Rate	-1.00%
Principal Amount	$50.00
Initial Index Level	100
Note Return	--39.38%
Cumulative Index Return	-19.63%

Day	Index Level	Daily Index Performance	Index Performance Factor	Daily Investor Fee	Fee Accrual	Daily Interest	Deposit Amount	Short Index Amount	Indicative Note Value	Note Return
A	B	C	D	E	F	G	H	I	J	K
	—									
Other long-term assets	$	—		$	—			$	—	
Accrued expenses and other current liabilities	$	—		$	—			$	3	
Lease incentives and other long-term liabilities	$	—		$	—			$	—	
Derivatives not designated as hedging instruments:										
Other current assets	$	14		$	3			$	3	
Other long-term assets	$	—		$	—			$	—	
Accrued expenses and other current liabilities	$	3		$	11			$	12	
Lease incentives and other long-term	$	—		$	—			$	—	

liabilities

Total derivatives in an asset position	$	40	$	14	$	20
Total derivatives in a liability position	$	7	$	43	$	52

The majority of the unrealized gains and losses from designated cash flow hedges as of August 4, 2018, will be recognized in income within the next 12 months at the then-current values, which may differ from the fair values as of August 4, 2018, shown above.

Our foreign exchange forward contracts are subject to master netting arrangements with each of our counterparties and such arrangements are enforceable in the event of default or early termination of the contract. We do not elect to offset the fair values of our derivative financial instruments on the Condensed Consolidated Balance Sheets, and as such, the fair values shown above represent gross amounts. The amounts subject to enforceable master netting arrangements are $4 million, $1 million, and $13 million as of August 4, 2018, February 3, 2018, and July 29, 2017, respectively. If we did elect to offset, the net amounts of our derivative financial instruments in an asset position would be $36 million, $13 million, and $7 million and the net amounts of the derivative financial instruments in a liability position would be $3 million, $42 million, and $39 million as of August 4, 2018, February 3, 2018, and July 29, 2017, respectively.

See Note 4 of Notes to Condensed Consolidated Financial Statements for disclosures on the fair value measurements of our derivative financial instruments.

The effective portion of gains and losses on foreign exchange forward contracts in cash flow hedging and net investment hedging relationships recorded in other comprehensive income and the Condensed Consolidated Statements of Income, on a pre-tax basis, are as follows:

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Derivatives in cash flow hedging relationships:				
Gain (loss) recognized in other comprehensive income	$21	$ (55)	$43	$ (51)
Gain reclassified into cost of goods sold and occupancy expenses	$—	$ 1	$3	$ 7
Gain (loss) reclassified into operating expenses	$—	$ —	$—	$ —
Derivatives in net investment hedging relationships:				
Loss recognized in other comprehensive income	$—	$ (3)	$—	$ (2)

For the thirteen and twenty-six weeks ended August 4, 2018 and July 29, 2017, there were no amounts of gains or losses reclassified from accumulated other comprehensive income into net income for derivative financial instruments in net investment hedging relationships, as we did not sell or liquidate (or substantially liquidate) any of our hedged subsidiaries during the periods.

Gains and losses on foreign exchange forward contracts not designated as hedging instruments recorded in the Condensed Consolidated Statements of Income, on a pre-tax basis, are as follows:

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Gain (loss) recognized in operating expenses	$12	$ (11)	$24	$ (23)

Note 6. Share Repurchases

Share repurchase activity is as follows:

($ and shares in millions except average per share cost)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Number of shares repurchased (1)	3.2	4.5	6.4	8.7
Total cost	$100	$100	$200	$200
Average per share cost including commissions	$30.95	$22.30	$31.08	$23.15

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(1) Excludes shares withheld to settle employee statutory tax withholding related to the vesting of stock units.

In February 2016, the Board of Directors approved a $1.0 billion share repurchase authorization, of which $485 million was remaining as of August 4, 2018.

All of the share repurchases were paid for as of August 4, 2018, February 3, 2018, and July 29, 2017. All common stock repurchased is immediately retired.

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Note 7. Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income by component, net of tax, are as follows:

($ in millions)	Foreign Currency Translation	Cash Flow Hedges	Total
Balance at February 3, 2018	$ 64	$ (28)	$ 36
13 Weeks Ended May 5, 2018:			
Foreign currency translation and other, net	(7)	—	(7)
Change in fair value of derivative financial instruments	—	28	28
Amounts reclassified from accumulated other comprehensive income	—	(6)	(6)
Other comprehensive income (loss), net of tax	(7)	22	15
Balance at May 5, 2018	57	(6)	51
13 Weeks Ended August 4, 2018:			
Foreign currency translation and other, net	(16)	—	(16)
Change in fair value of derivative financial instruments	—	18	18
Amounts reclassified from accumulated other comprehensive income	—	—	—
Other comprehensive income (loss), net of tax	(16)	18	2
Balance at August 4, 2018	$ 41	$ 12	$ 53

($ in millions)	Foreign Currency Translation	Cash Flow Hedges	Total
Balance at January 28, 2017	$ 29	$ 25	$ 54
13 Weeks Ended April 29, 2017:			
Foreign currency translation and other, net	(4)	—	(4)
Change in fair value of derivative financial instruments	—	—	—
Amounts reclassified from accumulated other comprehensive income	—	(4)	(4)
Other comprehensive loss, net of tax	(4)	(4)	(8)
Balance at April 29, 2017	25	21	46
13 Weeks Ended July 29, 2017:			
Foreign currency translation and other, net	21	—	21
Change in fair value of derivative financial instruments	—	(43)	(43)
Amounts reclassified from accumulated other comprehensive income	—	(1)	(1)
Other comprehensive income (loss), net of tax	21	(44)	(23)
Balance at July 29, 2017	$ 46	$ (23)	$ 23

See Note 5 of Notes to Condensed Consolidated Financial Statements for additional disclosures about reclassifications out of accumulated other comprehensive income and their corresponding effects on the respective line items in the Condensed Consolidated Statements of Income.

Note 8. Share-Based Compensation

Share-based compensation expense recognized in the Condensed Consolidated Statements of Income, primarily in operating expenses, is as follows:

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Stock units	$ 22	$ 18	$ 38	$ 33
Stock options	4	3	8	7
Employee stock purchase plan	1	1	2	2

Share-based compensation expense	27	22	48	42
Less: Income tax benefit	(6)	(8)	(12)	(16)
Share-based compensation expense, net of tax	$21	$ 14	$36	$ 26

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Note 9. Income Taxes

The effective income tax rate was 23.5 percent for the thirteen weeks ended August 4, 2018, compared with 38.3 percent for the thirteen weeks ended July 29, 2017. The effective income tax rate was 24.1 percent for the twenty-six weeks ended August 4, 2018, compared with 38.8 percent for the twenty-six weeks ended July 29, 2017. The decrease in the effective tax rates was primarily due to the reduction in the U.S. federal statutory tax rate from 35 percent to 21 percent, enacted as part of the Tax Cuts and Jobs Act of 2017 (the "TCJA").

On December 22, 2017, the Securities and Exchange Commission ("SEC") issued SEC Staff Accounting Bulletin ("SAB") No. 118 to address the application of FASB ASC Topic 740, Income Taxes, in reporting periods that include December 22, 2017. SAB No. 118, codified under ASU 2018-05 in March 2018, permits organizations to report provisional amounts during a measurement period for the specific income tax effects of the TCJA for which the accounting under ASC Topic 740 will be incomplete but a reasonable estimate can be determined. The measurement period ends when an organization has obtained, prepared and analyzed the information needed to complete the accounting requirements under ASC Topic 740, not to extend beyond one year from the enactment date of the TCJA. During the fourteen weeks ended February 3, 2018, we recorded an estimated net charge of $57 million for the effects of the enactment of TCJA, primarily due to the impact of the one-time transition tax on the deemed repatriation of foreign income and the impact of TCJA on deferred tax assets and liabilities. During the thirteen weeks ended May 5, 2018, we did not make any measurement period adjustments related to our provisional estimated net charge. During the thirteen weeks ended August 4, 2018, we made certain immaterial measurement period adjustments to our fiscal 2017 provisional estimated net charge of $57 million for the impacts of deferred tax assets and liabilities subject to the TCJA rate reduction. We will continue to evaluate the TCJA, collect and prepare necessary data, and interpret additional guidance issued by the U.S. Treasury Department and Internal Revenue Service ("IRS"), including the proposed regulations regarding the computation of the one-time transition tax on the deemed repatriation of foreign income. In accordance with SAB No. 118, we will complete our accounting for the tax effects of the TCJA during fiscal 2018 and adjustments to our provisional estimated net charge may materially impact our provision for income taxes and effective tax rate in the period in which the adjustments are made.

The TCJA includes a provision to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries, a base erosion anti-abuse tax ("BEAT") measure that taxes certain payments between a U.S. corporation and its subsidiaries, and favorable tax treatment for certain Foreign Derived Intangible Income ("FDII"), effective for us beginning fiscal 2018. Our provisional estimates for GILTI, BEAT, and FDII do not materially impact our effective income tax rate for the thirteen and twenty-six weeks ended August 4, 2018.

The Company conducts business globally, and as a result, files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, Canada, France, the United Kingdom, China, Hong Kong, Japan, and India. We are no longer subject to U.S. federal income tax examinations for fiscal years before 2009, and with few exceptions, we are also no longer subject to U.S. state, local, or non-U.S. income tax examinations for fiscal years before 2008.

The Company is in continual discussions with taxing authorities regarding tax matters in the various U.S. and foreign jurisdictions in the normal course of business. As of August 4, 2018, we have not identified any gross unrecognized tax benefits where it is reasonably possible we will recognize a decrease within the next 12 months.

Note 10. Earnings Per Share

Weighted-average number of shares used for earnings per share is as follows:

(shares in millions)	13 Weeks Ended August 4, 2018	July 29, 2017	26 Weeks Ended August 4, 2018	July 29, 2017
Weighted-average number of shares - basic	387	395	388	397
Common stock equivalents	3	1	3	1
Weighted-average number of shares - diluted	390	396	391	398

The above computations of weighted-average number of shares – diluted exclude 6 million and 11 million shares related to stock options and other stock awards for the thirteen weeks ended August 4, 2018 and July 29, 2017, respectively, and 6 million and 9 million shares related to stock options and other stock awards for the twenty-six weeks ended August 4, 2018 and July 29, 2017, respectively, as their inclusion would have an anti-dilutive effect on earnings per share.

Note 11. Commitments and Contingencies
We are a party to a variety of contractual agreements under which we may be obligated to indemnify the other party for certain matters. These contracts primarily relate to our commercial contracts, operating leases, trademarks, intellectual property, financial agreements, and various other agreements. Under these contracts, we may provide certain routine indemnifications relating to representations and warranties (e.g., ownership of assets, environmental or tax indemnifications), or personal injury matters. The terms of these indemnifications range in duration and may not be explicitly defined. Generally, the maximum obligation under such indemnifications is not explicitly stated, and as a result, the overall amount of these obligations cannot be reasonably estimated. Historically, we have not made significant payments for these indemnifications. We believe that if we were to incur a loss in any of these matters, the loss would not have a material effect on our Condensed Consolidated Financial Statements taken as a whole.
As a multinational company, we are subject to various proceedings, lawsuits, disputes, and claims ("Actions") arising in the ordinary course of our business. Many of these Actions raise complex factual and legal issues and are subject to uncertainties. As of August 4, 2018, Actions filed against us included commercial, intellectual property, customer, employment, and data privacy claims, including class action lawsuits. The plaintiffs in some Actions seek unspecified damages or injunctive relief, or both. Actions are in various procedural stages and some are covered in part by insurance. As of August 4, 2018, February 3, 2018, and July 29, 2017, we recorded a liability for an estimated loss if the outcome of an Action is expected to result in a loss that is considered probable and reasonably estimable. The liability recorded as of August 4, 2018, February 3, 2018, and July 29, 2017 was not material for any individual Action or in total. Subsequent to August 4, 2018 and through the filing date of this Quarterly Report on Form 10-Q, no information has become available that indicates a change is required that would be material to our Condensed Consolidated Financial Statements taken as a whole.
We cannot predict with assurance the outcome of Actions brought against us. Accordingly, developments, settlements, or resolutions may occur and impact income in the quarter of such development, settlement, or resolution. However, we do not believe that the outcome of any current Action would have a material effect on our Condensed Consolidated Financial Statements taken as a whole.

Fire at the Fishkill Distribution Center
On August 29, 2016, a fire occurred in one of the buildings at a Company-owned distribution center campus in Fishkill, New York. The Company maintains property and business interruption insurance coverage and, based on the provisions of the Company's insurance policies, the Company recorded insurance recoveries based on the determination that recovery of certain fire-related costs was probable. In January 2018, the Company agreed upon a final settlement with its insurers.
During the thirteen weeks ended July 29, 2017, the Company agreed upon a partial insurance settlement and recorded a gain of $64 million, primarily related to property and equipment, representing the excess over the loss on fire-related recoverable costs, which was recorded in operating expenses in the Condensed Consolidated Statement of Income. During the twenty-six weeks ended July 29, 2017, we allocated $59 million of advance payments of insurance proceeds to the loss on property and equipment based on the current estimate of recovery of certain fire-related costs, and the amount has been reported as insurance proceeds allocated to loss on property and equipment, a component of cash flows from investing activities, in the Condensed Consolidated Statement of Cash Flows.

Note 12. Segment Information
The Gap, Inc. is a global retailer that sells apparel, accessories, and personal care products under the Old Navy, Gap, Banana Republic, Athleta, and Intermix brands. We identify our operating segments according to how our business activities are managed and evaluated. As of August 4, 2018, our operating segments included Old Navy Global, Gap Global, Banana Republic Global, Athleta, and Intermix. We have determined that each of our operating segments share similar economic and other qualitative characteristics, and therefore the results of our operating segments are aggregated into one reportable segment as of August 4, 2018.

Net sales by brand and region are as follows:

($ in millions) 13 Weeks Ended August 4, 2018 (1)	Old Navy Global	Gap Global	Banana Republic Global	Other (3)	Total	Percentage of Net Sales
U.S. (2)	$ 1,816	$ 728	$ 514	$ 264	$ 3,322	82 %
Canada	151	94	58	—	303	7
Europe	—	145	3	—	148	4
Asia	11	229	22	—	262	6
Other regions	14	29	7	—	50	1
Total	$ 1,992	$ 1,225	$ 604	$ 264	$ 4,085	100 %

($ in millions) 13 Weeks Ended July 29, 2017 (1)	Old Navy Global	Gap Global	Banana Republic Global	Other (3)	Total	Percentage of Net Sales
U.S. (2)	$ 1,596	$ 719	$ 492	$ 231	$ 3,038	80 %
Canada	133	91	54	—	278	7
Europe	—	148	3	—	151	4
Asia	12	252	24	—	288	8
Other regions	16	22	6	—	44	1
Total	$ 1,757	$ 1,232	$ 579	$ 231	$ 3,799	100 %

($ in millions) 26 Weeks Ended August 4, 2018 (1)	Old Navy Global	Gap Global	Banana Republic Global	Other (3)	Total	Percentage of Net Sales
U.S. (2)	$ 3,406	$ 1,408	$ 993	$ 533	$ 6,340	81 %
Canada	278	171	108	1	558	7
Europe	—	280	7	—	287	4
Asia	23	513	47	—	583	7
Other regions	30	57	13	—	100	1
Total	$ 3,737	$ 2,429	$ 1,168	$ 534	$ 7,868	100 %

($ in millions) 26 Weeks Ended July 29, 2017 (1)	Old Navy Global	Gap Global	Banana Republic Global	Other (3)	Total	Percentage of Net Sales
U.S. (2)	$ 3,022	$ 1,387	$ 929	$ 433	$ 5,771	80 %
Canada	244	168	99	1	512	7
Europe	—	281	7	—	288	4
Asia	21	502	48	—	571	8
Other regions	32	52	13	—	97	1
Total	$ 3,319	$ 2,390	$ 1,096	$ 434	$ 7,239	100 %

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(1) Net sales for the thirteen and twenty-six weeks ended August 4, 2018 reflect the adoption of the new revenue recognition standard, which resulted in an increase to net sales of $139 million and $279 million, respectively, for revenue sharing and reimbursements of loyalty program discounts associated with the Company's credit card programs, as well as breakage revenue for our gift cards and credit vouchers. Prior period amounts have not been restated and continue to be reported under accounting standards in effect for those periods.

(2) U.S. includes the United States, Puerto Rico, and Guam.

(3) Primarily consists of net sales for the Athleta and Intermix brands.

Net sales by region are allocated based on the location of the store where the customer paid for and received the merchandise or the distribution center or store from which the products were shipped.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
OUR BUSINESS
We are a global retailer offering apparel, accessories, and personal care products for men, women, and children under the Old Navy, Gap, Banana Republic, Athleta, and Intermix brands. We have Company-operated stores in the United States, Canada, the United Kingdom, France, Ireland, Japan, Italy, China, Hong Kong, Taiwan, and Mexico. We have franchise agreements with unaffiliated franchisees to operate Gap, Banana Republic, and Old Navy stores throughout Asia, Europe, Latin America, the Middle East, and Africa. Under these agreements, third parties operate, or will operate, stores that sell apparel and related products under our brand names. Our products are also available to customers online through Company-owned websites and through the use of third parties that provide logistics and fulfillment services. In addition to operating in the specialty, outlet, online, and franchise channels, we also use our omni-channel capabilities to bridge the digital world and physical stores to further enhance our shopping experience for our customers. Our omni-channel services, including order-in-store, reserve-in-store, find-in-store, and ship-from-store, as well as enhanced mobile experiences, are tailored uniquely across our portfolio of brands. Most of the products sold under our brand names are designed by us and manufactured by independent sources. We also sell products that are designed and manufactured by branded third parties, primarily at our Intermix brand.
OVERVIEW
During the first quarter of fiscal 2018, we adopted the new revenue recognition standard, ASC 606, using the modified retrospective transition method and recorded an increase to opening retained earnings of $36 million, net of tax. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The adoption of the new revenue recognition standard did not have a significant impact to net income for the first half of fiscal 2018, but did have a significant impact to the presentation of net sales, cost of goods sold and occupancy expenses, and operating expenses in the Condensed Consolidated Statement of Income. The presentation changes primarily consist of $96 million and $192 million for the thirteen and twenty-six weeks ended August 4, 2018, respectively, for revenue sharing associated with our credit card programs and breakage revenue for gift cards and credit vouchers, which now is recorded as net sales and previously was recorded as a reduction to operating expenses in our Condensed Consolidated Statements of Income; and $43 million and $87 million for the thirteen and twenty-six weeks ended August 4, 2018, respectively, for reimbursements of loyalty program discounts associated with our credit card programs, which now is recorded as net sales and previously was recorded as a reduction to cost of goods sold and occupancy expenses in our Condensed Consolidated Statements of Income. See Note 2 of Notes to Condensed Consolidated Financial Statements for additional disclosures about the adoption of the new revenue standard.
Financial results for the second quarter of fiscal 2018 are as follows:

- Net sales for the second quarter of fiscal 2018 increased 8 percent compared with the second quarter of fiscal 2017.
- Comparable sales for the second quarter of fiscal 2018 increased 2 percent compared with a 1 percent increase for the second quarter of fiscal 2017.
- Gross profit for the second quarter of fiscal 2018 was $1.6 billion compared with $1.5 billion for the second quarter of fiscal 2017. Gross margin for the second quarter of fiscal 2018 was 39.8 percent compared with 38.9 percent for the second quarter of fiscal 2017.
- Operating margin for the second quarter of fiscal 2018 was 9.7 percent compared with 11.9 percent for the second quarter of fiscal 2017, which includes a gain on insurance proceeds of $64 million related to the fire that occurred at the Fishkill, New York Company-owned distribution center.
- Net income for the second quarter of fiscal 2018 was $297 million compared with $271 million for the second quarter of fiscal 2017.
- Diluted earnings per share was $0.76 for the second quarter of fiscal 2018 compared with $0.68 for the second quarter of fiscal 2017.
- During the first half of fiscal 2018, we distributed $388 million to shareholders through share repurchases and dividends.

Our business priorities for fiscal 2018 remain as follows:

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offering product that is consistently brand-appropriate and on-trend with high customer acceptance, with a focus on expanding our advantage in core businesses and loyalty categories;

- investing in digital and customer capabilities to support growth;
- creating a unique and differentiated converged retail shopping experience that attracts new customers and builds loyalty, with focus on both the physical and digital expressions of our brands;
- increasing productivity by leveraging our scale and streamlining operations and processes throughout the organization;
- continuing to integrate social and environmental sustainability into business practices to support long term growth; and
- attracting and retaining strong talent in our businesses and functions.

In fiscal 2018, we are focused on investing strategically in the business while maintaining operating expense discipline and driving efficiency through our productivity initiative. One of our primary objectives is to continue transforming our product to market process, with the development of a more efficient operating model, allowing us to more fully leverage our scale. To enable this, we have a number of product, supply chain, and IT initiatives underway. Furthermore, we expect to continue our investment in customer experience to drive higher customer engagement and loyalty across all of our brands and channels, resulting in market share gains. Finally, we will continue to invest in strengthening brand awareness, customer acquisition, and digital capabilities. Underpinning these strategies is a focus on utilizing data, analytics, and technology to respond faster while making decisions that will fuel market share gains and lead to a more nimble organization.

RESULTS OF OPERATIONS

Net Sales

See Note 12 of Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q, for net sales by brand and region.

Comparable Sales (“Comp Sales”)

Fiscal 2018 consists of 52 weeks versus 53 weeks in fiscal 2017. Due to the 53rd week in fiscal 2017, in order to maintain consistency, comparable ("Comp") sales for the second quarter of fiscal 2018 and the first half of fiscal 2018 are compared to the thirteen and twenty-six weeks ended August 5, 2017.

The percentage change in Comp Sales by global brand and for The Gap, Inc., as compared with the preceding year, is as follows:

	13 Weeks Ended		26 Weeks Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Old Navy Global	5 %	5 %	4 %	6 %
Gap Global	(5)%	(1)%	(5)%	(2)%
Banana Republic Global	2 %	(5)%	2 %	(5)%
The Gap, Inc.	2 %	1 %	1 %	2 %

Comp Sales include merchandise sales in Company-operated stores and merchandise sales through online channels in those countries where we have existing comparable store sales. The calculation of The Gap, Inc. Comp Sales includes the results of Athleta and Intermix, but excludes the results of our franchise business.

A store is included in the Comp Sales calculations when it has been open and operated by the Company for at least one year and the selling square footage has not changed by 15 percent or more within the past year. A store is included in the Comp Sales calculations on the first day it has comparable prior year sales. Stores in which the selling square footage has changed by 15 percent or more as a result of a remodel, expansion, or reduction are excluded from the Comp Sales calculations until the first day they have comparable prior year sales.

A store is considered non-comparable (“Non-comp”) when it has been open and operated by the Company for less than one year or has changed its selling square footage by 15 percent or more within the past year.

A store is considered “Closed” if it is temporarily closed for three or more full consecutive days or it is permanently closed. When a temporarily closed store reopens, the store will be placed in the Comp/Non-comp status it was in prior to its closure. If a store was in Closed status for three or more days in the prior year, the store will be in Non-comp status for the same days the following year.

Current year foreign exchange rates are applied to both current year and prior year Comp Sales to achieve a consistent basis for comparison.

Store Count and Square Footage Information

Net sales per average square foot are as follows:

	13 Weeks Ended		26 Weeks Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net sales per average square foot (1)	$ 90	$ 85	169	$ 160

(1) Excludes net sales associated with our online and franchise businesses. Online sales includes both sales through our online channels as well as ship-from-store sales.

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Store count, openings, closings, and square footage for our stores are as follows:

	February 3, 2018	26 Weeks Ended August 4, 2018		August 4, 2018	
	Number of Store Locations	Number of Stores Opened	Number of Stores Closed	Number of Store Locations	Square Footage (in millions)
Old Navy North America	1,066	30	2	1,094	18.1
Old Navy Asia	14	—	—	14	0.2
Gap North America	810	4	14	800	8.2
Gap Asia	313	9	3	319	3.1
Gap Europe	155	5	5	155	1.3
Banana Republic North America	576	3	9	570	4.8
Banana Republic Asia	45	2	3	44	0.2
Athleta North America	148	7	1	154	0.6
Intermix North America	38	—	1	37	0.1
Company-operated stores total	3,165	60	38	3,187	36.6
Franchise	429	47	37	439	N/A
Total	3,594	107	75	3,626	36.6
Increase (decrease) over prior year				(0.4)%	0.3 %

	January 28, 2017	26 Weeks Ended July 29, 2017		July 29, 2017	
	Number of Store Locations	Number of Stores Opened	Number of Stores Closed	Number of Store Locations	Square Footage (in millions)
Old Navy North America	1,043	13	5	1,051	17.5
Old Navy Asia	13	—	—	13	0.2
Gap North America	844	3	13	834	8.6
Gap Asia	311	3	9	305	2.9
Gap Europe	164	—	5	159	1.4
Banana Republic North America	601	3	8	596	5.0
Banana Republic Asia	48	1	1	48	0.2
Banana Republic Europe	1	—	1	—	—
Athleta North America	132	1	—	133	0.6
Intermix North America	43	—	3	40	0.1
Company-operated stores total	3,200	24	45	3,179	36.5
Franchise	459	22	18	463	N/A
Total	3,659	46	63	3,642	36.5
Decrease over prior year				(2.4)%	(3.4)%

Gap and Banana Republic outlet and factory stores are reflected in each of the respective brands.

Net Sales

Our net sales for the second quarter of fiscal 2018 increased $286 million, or 8 percent, compared with the second quarter of fiscal 2017 primarily driven by an increase in Comp Sales for Old Navy Global, an increase in new stores, and the impact of significant presentation changes of $139 million resulting from the adoption of the new revenue recognition standard.

Our net sales for the first half of fiscal 2018 increased $629 million, or 9 percent, compared with the first half of fiscal 2017 primarily driven by an increase in Comp Sales for Old Navy Global, the impact of significant presentation changes of $279 million resulting from the adoption of the new revenue recognition standard, and a net favorable impact of foreign exchange of $65 million. The foreign exchange impact is the translation impact if net sales for the first half of fiscal 2017 were translated at exchange rates applicable during the first half of fiscal 2018.

Cost of Goods Sold and Occupancy Expenses

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Cost of goods sold and occupancy expenses	$2,458	$2,320	$4,814	$4,457
Gross profit	$1,627	$1,479	$3,054	$2,782
Cost of goods sold and occupancy expenses as a percentage of net sales	60.2 %	61.1 %	61.2 %	61.6 %
Gross margin	39.8 %	38.9 %	38.8 %	38.4 %

Cost of goods sold and occupancy expenses decreased 0.9 percentage points as a percentage of net sales in the second quarter of fiscal 2018 compared with the second quarter of fiscal 2017.

- Cost of goods sold increased 0.3 percentage points as a percentage of net sales in the second quarter of fiscal 2018 compared with the second quarter of fiscal 2017, primarily driven by lower product margin at Gap Global, and higher online shipping costs. This was partially offset by a favorable impact from presentation changes resulting from the adoption of the new revenue recognition standard.
- Occupancy expenses decreased 1.2 percentage points as a percentage of net sales in the second quarter of fiscal 2018 compared with the second quarter of fiscal 2017, primarily driven by presentation changes resulting from the adoption of the new revenue recognition standard, store closures, and an increase in online sales without a corresponding increase in occupancy expenses.

Cost of goods sold and occupancy expenses decreased 0.4 percentage points as a percentage of net sales in the first half of fiscal 2018 compared with the first half of fiscal 2017.

- Cost of goods sold increased 0.8 percentage points as a percentage of net sales in the first half of fiscal 2018 compared with the first half of fiscal 2017, primarily driven by higher online shipping costs, higher inventory write-offs at Gap Global, and lower product margin at Gap Global. This was partially offset by a favorable impact from presentation changes resulting from the adoption of the new revenue recognition standard.
- Occupancy expenses decreased 1.2 percentage points as a percentage of net sales in the first half of fiscal 2018 compared with the first half of fiscal 2017, primarily driven by presentation changes resulting from the adoption of the new revenue recognition standard, an increase in online sales without a corresponding increase in occupancy expenses, and store closures.

Operating Expenses

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Operating expenses	$1,229	$1,028	$2,427	$2,077
Operating expenses as a percentage of net sales	30.1 %	27.1 %	30.8 %	28.7 %
Operating margin	9.7 %	11.9 %	8.0 %	9.7 %

Operating expenses increased $201 million, or 3.0 percentage points as a percentage of net sales in the second quarter of fiscal 2018 compared with the second quarter of fiscal 2017. Operating expenses increased $350 million, or 2.1 percentage points as a percentage of net sales in the first half of fiscal 2018 compared with the first half of fiscal 2017. The increase in operating expenses for the second quarter and first half of fiscal 2018 compared with the respective periods of 2017 was primarily due to the following:

- presentation changes resulting from the adoption of the new revenue recognition standard;
- a gain on insurance proceeds of $64 million in the second quarter of fiscal 2017 related to the fire that occurred at the Fishkill, New York Company-owned distribution center; and
- an increase in expenses related to payroll and benefits, primarily at stores and distribution centers due to increased volume.

Interest Expense

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Interest expense	$17	$ 16	$33	$ 35

Interest expense primarily includes interest on overall borrowings and obligations mainly related to our $1.25 billion 5.95 percent Notes.

Income Taxes

($ in millions)	13 Weeks Ended August 4, 2018	13 Weeks Ended July 29, 2017	26 Weeks Ended August 4, 2018	26 Weeks Ended July 29, 2017
Income taxes	$91	$168	$146	$263
Effective tax rate	23.5%	38.3 %	24.1 %	38.8 %

The decrease in the effective tax rate for the second quarter and first half of fiscal 2018 compared with the respective periods of fiscal 2017 is primarily due to the reduction in the U.S. federal statutory tax rate from 35% to 21%, enacted as part of the Tax Cuts and Jobs Act of 2017 (the "TCJA").

During the fourth quarter of fiscal 2017, we calculated our best estimate of the impact associated the TCJA one-time transition tax on the deemed repatriation of foreign income and the impact of TCJA on deferred tax assets and liabilities. During the thirteen weeks ended August 4, 2018, we made certain immaterial measurement period adjustments to our fiscal 2017 provisional estimated net charge of $57 million for the impacts of deferred tax assets and liabilities subject to the TCJA rate reduction. We continue to evaluate the TCJA, collect and prepare necessary data, and interpret additional guidance issued by the U.S. Treasury Department and Internal Revenue Service ("IRS") and will complete our accounting for the impact of the TCJA during fiscal 2018.

LIQUIDITY AND CAPITAL RESOURCES

Our largest source of cash flows is cash collections from the sale of our merchandise. Our primary uses of cash include merchandise inventory purchases, occupancy costs, personnel-related expenses, purchases of property and equipment, and payment of taxes. In addition, we may have dividend payments, debt repayments, and share repurchases. As of August 4, 2018, cash, cash equivalents, and short-term investments were $1.6 billion, the majority of which was held in the United States and is generally accessible without any limitations.

We believe that current cash balances and cash flows from our operations will be sufficient to support our business operations, including growth initiatives and planned capital expenditures, for the next 12 months and beyond. We are also able to supplement near-term liquidity, if necessary, with our $500 million revolving credit facility or other available market instruments.

Cash Flows from Operating Activities

Net cash from operating activities increased $60 million during the first half of fiscal 2018 compared with the first half of fiscal 2017, primarily due to the following:

- an increase of $153 million related to accounts payable primarily due to the timing of inventory and lease payments;
- an increase of $47 million in net income; partially offset by
- a decrease of $98 million in income taxes payable primarily due to the federal statutory tax rate decrease; and
- a decrease of $69 million related to accrued expenses and other current liabilities primarily due to higher bonus payout in fiscal 2018 compared with the bonus payout in fiscal 2017.

We fund inventory expenditures during normal and peak periods through cash flows from operating activities and available cash. Our business follows a seasonal pattern, with sales peaking during the end-of-year holiday period. The seasonality of our operations may lead to significant fluctuations in certain asset and liability accounts between fiscal year-end and subsequent interim periods.

Cash Flows from Investing Activities
Net cash used for investing activities during the first half of fiscal 2018 increased $402 million compared with the first half of fiscal 2017, primarily due to the following:

- $286 million of net purchases of available-for-sale securities during fiscal 2018; and
- $59 million of insurance proceeds allocated to the loss on property and equipment during the first half of fiscal 2017.

Cash Flows from Financing Activities
Net cash used for financing activities during the first half of fiscal 2018 decreased $73 million compared with the first half of fiscal 2017, primarily due to a $67 million repayment of the Japan term loan during the first half of fiscal 2017.

Free Cash Flow
Free cash flow is a non-GAAP financial measure. We believe free cash flow is an important metric because it represents a measure of how much cash a company has available for discretionary and non-discretionary items after the deduction of capital expenditures, net of insurance proceeds related to loss on property and equipment, as we require regular capital expenditures to build and maintain stores and purchase new equipment to improve our business. We use this metric internally, as we believe our sustained ability to generate free cash flow is an important driver of value creation. However, this non-GAAP financial measure is not intended to supersede or replace our GAAP results.
The following table reconciles free cash flow, a non-GAAP financial measure, from a GAAP financial measure.

($ in millions)	26 Weeks Ended August 4, 2018	July 29, 2017
Net cash provided by operating activities	$546	$ 486
Less: Purchases of property and equipment	(326)	(275)
Add: Insurance proceeds related to loss on property and equipment	—	59
Free cash flow	$220	$ 270

Debt and Credit Facilities
Certain financial information about the Company’s debt and credit facilities is set forth under the heading “Debt and Credit Facilities” in Note 3 of Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q.

Dividend Policy
In determining whether and at what level to declare a dividend, we consider a number of factors including sustainability, operating performance, liquidity, and market conditions.
We paid a dividend of $0.485 per share and $0.46 per share during the first half of fiscal 2018 and fiscal 2017, respectively. Including the dividend paid during the first half of fiscal 2018, we intend to pay an annual dividend of $0.97 per share for fiscal 2018 compared with the annual dividend of $0.92 per share for fiscal 2017.

Share Repurchases
Certain financial information about the Company’s share repurchases is set forth under the heading “Share Repurchases” in Note 6 of Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q.

Summary Disclosures about Contractual Cash Obligations and Commercial Commitments
There have been no material changes to our contractual obligations and commercial commitments as disclosed in our Annual Report on Form 10-K as of February 3, 2018, other than those which occur in the normal course of business. See Note 11 of Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q, for disclosures on commitments and contingencies.

Critical Accounting Policies and Estimates

Except for changes resulting from the adoption of new accounting standards during the period, there have been no significant changes to our critical accounting policies and estimates as discussed in our Annual Report on Form 10-K for the fiscal year ended February 3, 2018. See Note 2 of Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q, for disclosures on accounting policies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.
Our market risk profile as of February 3, 2018, is disclosed in our Annual Report on Form 10-K and has not significantly changed. See Notes 3, 4, and 5 of Notes to Condensed Consolidated Financial Statements included in Part I, Item 1, of this Form 10-Q, for disclosures on our debt, investments, and derivative financial instruments.

Item 4. Controls and Procedures.
Evaluation of Disclosure Controls and Procedures
We carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting
There was no change in the Company’s internal control over financial reporting that occurred during the Company’s second quarter of fiscal 2018 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

As a multinational company, we are subject to various proceedings, lawsuits, disputes, and claims arising in the ordinary course of our business. Many of these Actions raise complex factual and legal issues and are subject to uncertainties. Actions filed against us from time to time include commercial, intellectual property, customer, employment, and data privacy claims, including class action lawsuits. The plaintiffs in some Actions seek unspecified damages or injunctive relief, or both. Actions are in various procedural stages, and some are covered in part by insurance.

We cannot predict with assurance the outcome of Actions brought against us. Accordingly, developments, settlements, or resolutions may occur and impact income in the quarter of such development, settlement, or resolution. However, we do not believe that the outcome of any current Action would have a material effect on our financial results.

Item 1A. Risk Factors.

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 3, 2018, other than what was previously disclosed in Part II, Item 1A of our Quarterly Report on Form 10-Q for the fiscal quarter ended May 5, 2018.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table presents information with respect to purchases of common stock of the Company made during the thirteen weeks ended August 4, 2018 by The Gap, Inc. or any affiliated purchaser, as defined in Exchange Act Rule 10b-18(a)(3):

	Total Number of Shares Purchased (1)	Average Price Paid Per Share Including Commissions	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or approximate dollar amount) of Shares that May Yet be Purchased Under the Plans or Programs (2)
Month #1 (May 6 - June 2)	407,272	$ 28.52	407,272	$ 573 million
Month #2 (June 3 - July 7)	1,686,360	$ 32.14	1,686,360	$ 519 million
Month #3 (July 8 - August 4)	1,138,830	$ 30.04	1,138,830	$ 485 million
Total	3,232,462	$ 30.95	3,232,462	

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(1) Excludes shares withheld to settle employee statutory tax withholding related to the vesting of stock units.

(2) On February 25, 2016, we announced that the Board of Directors approved a $1 billion share repurchase authorization, which has no expiration date.

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Item 6. Exhibits.

10.1	Second Amended and Restated Revolving Credit Agreement dated May 31, 2018. (2).
10.2	Sixth Amendment to Amended and Restated Consumer Credit Card Program Agreement by and among the Registrant, Gap (Puerto Rico), Inc., GPS Consumer Direct, Inc., Gap (Apparel), LLC, Gap (ITM) Inc., Synchrony Bank (f/k/a GE Capital Retail Bank) and Synchrony Financial, dated as of May 22, 2018. (1) (2)
10.3	Agreement with Neil Fiske dated June 11, 2018. (2)
10.4	Agreement with Art Peck dated June 1, 2018, filed as Exhibit 10.1 to Registrant's Form 8-K on June 4, 2018, Commission File No. 1-7562.
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer of The Gap, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002). (2)
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer of The Gap, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002). (2)
32.1	Certification of the Chief Executive Officer of The Gap, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (3)
32.2	Certification of the Chief Financial Officer of The Gap, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (3)
101	The following materials from The Gap, Inc.'s Quarterly Report on Form 10-Q for the quarter ended August 4, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements. (2)

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(1) Pursuant to a request for confidential treatment, confidential portions of this Exhibit have been redacted and have been filed separately with the Securities
and Exchange Commission.
(2) Filed herewith.
(3) Furnished herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

			THE GAP, INC.
Date:	August 31, 2018	By	/s/ Arthur Peck Arthur Peck Chief Executive Officer
Date:	August 31, 2018	By	/s/ Teri List-Stoll Teri List-Stoll Executive Vice President and Chief Financial Officer

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Exhibit Index

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(3) Furnished herewith.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

Executive Officers and Directors

We have provided below certain information about our executive officers and directors. Our directors serve for a term of one year or until their successors are duly elected. Our executive officers serve at the pleasure of our board of directors and have no fixed term of office.

Name	Age	Position
Brian Lin	44	Director and Chief Executive Officer
Weishe Zhang	44	Director and Chief Technology Officer
Xiaoyuan (Robert) Yuan	34	Principal Accounting Officer
Weigang Li	51	Vice President of Sales
Haijun Yang	36	Vice President of Operations

Gangjin Li	47	Chairman of the Board
Albert McLelland	50	Independent Director
Xianghua Li	64	Independent Director
Xuewen Xiao	40	Independent Director
Guoyou Zhang	57	Independent Director

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Mr. Brian Lin, CEO, Director, 44. Mr. Lin serves as Director and Chief Executive Officer of China Fire & Security Group, Inc. Mr. Lin has served as a Director since October 2006. Mr. Lin has over 17 years of management and technical experience both in the US and China. Mr. Lin is an early stage investor and co-founder of the Company and has been providing strategic guidance since its inception. Prior to joining the Company full time in January 2006, Mr. Lin served as CEO of Beijing Linkhead Technologies, and held various management and technical positions with UTStarcom in China and Nortel Networks and Motorola in the US from 2001 to 2005. Mr. Lin received his Master's Degree in Electrical Engineering from University of Toronto, Canada in 1989.

Mr. Weishe Zhang, Chief Technology Officer, Director, 44. Mr. Zhang has served as a director and our Chief Technology Officer since February 2009. From 2002 to February 2009, Mr. Zhang held various positions in the field of product research and development, including Director of System Integration, Director of Product Research and Development Center and Chief Engineer in Sureland Industrial (a wholly owned subsidiary of China Fire). With over 15 years of experience in the China fire protection industry, Mr. Zhang is the inventor of dozens of international and domestic product and technology patents. Mr. Zhang received a Master's Degree in Engineering from Beijing University of Aeronautics & Astronautics in 1989.

Mr. Weigang Li, Vice President of Sales of China Fire, General Manager of Sureland Industrial, 41. Mr. Li has served as our VP of Sales since February 2009. Mr. Li co-founded Sureland Industrial in 1995 and held various positions, including deputy director, director and deputy General Manager of Sales. Mr. Li has been influential in winning a number of large, notable contracts since the Company's inception. Mr. Li has over 15 years of hands on experience in project sales and sales force management in the China fire protection industry. He is currently completing a business diploma in an advanced program for young Chinese entrepreneurs at Tsinghua University. Mr. Li is the brother of Mr. Gangjin Li, the Chairman of the Board.

Mr. Haijun Yang, Vice President of Operations, the Company's Secretary, Deputy General Manager of Sureland Industrial, 36. Mr. Yang has served as our Vice President of Operations and the Company's Secretary since February 2009. From 2000 to February 2009, Mr. Yang held various positions including Executive Assistant to the General Manager, Secretary of the Board of Sureland and Deputy General Manager in charge of preparation for going public, merger and acquisition and operation management in Sureland Industrial. With 9 years of working experience in the China fire protection industry, Mr. Yang is responsible for internal operation management, including human resource, legal affairs, mergers and acquisitions, to support the Company's continued growth. Mr. Yang received his MBA from Renmin University of China in 2000 and is currently pursuing his Ph.D. in business management since 2004.

Mr. Xiaoyuan (Robert) Yuan, Principal Accounting Officer, 34, Mr. Xiaoyuan (Robert) Yuan joined the Company as the Company's Secretary in July 2007 and has served as the Principal Accounting Officer since August 2008. From October 2006 to July 2007, Mr. Yuan worked for CCG Elite Investor Relations, a global investor relations company, as an account executive representing a number of public companies listed in the U. S. From 2003 to 2005, Mr. Yuan held various positions in the fields of industry research, strategic planning and M&A for Lenovo Group Co. Ltd. (HKSE: 0992.HK), the largest PC manufacturer in China. Mr. Yuan graduated from Texas Christian University with his Ph.D. degree in Physics and MBA with concentration in finance in 2003.

Mr. Gangjin Li, Chairman of the Board, 47. Mr. Li has served as our Chairman of the Board since October 2006. Mr. Li is the founder of Sureland, and served as Chairman of the Board and the General Manager of Sureland Industrial from 1995 until January 2009. Mr. Li is an executive director of China Fire Protection Association (CFPA), and vice-chairman of "Electrical Fire Prevention Committee of CFPA". Mr. Li holds a bachelor's degree from Wuhan University of Science and Technology and a Master degree in management science from Beijing University.

Mr. Albert McLelland, Director, 50, Albert Mclelland has served as an independent Director since September 2008. Since 2003, Mr. McLelland has been the Senior Managing Director of AmPac Strategic Capital LLC (AmPac) Prior to founding AmPac, Mr. McLelland was responsible for the day-to-day operations of the cross-border transactions Initiative of PricewaterhouseCoopers' (PwC) Financial Advisory Services. Albert possesses extensive investment and merchant banking experience. He has built two Asian based financial service firms and also ran corporate finance at CEF Taiwan Limited. Mr. McLelland began his investment banking career at Shearson Lehman. Mr. McLelland is also teaching "Venturing in China" at the Caruth Institute for Entrepreneurship at the Cox School of Business at Southern Methodist University. Mr. McLelland holds an MBA degree from the University of Chicago and a Master of International Affairs from Columbia. He did his undergraduate studies at the University of South Florida and also studied Mandarin at the National Normal University in Taiwan.
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Mr. Xianghua Li, Director, 64, Mr. Xianghua Li has served as an independent Director since September 2008. Mr. Li was the vice chairman of China Fire Protection Association since October 2003. Mr. Li had his diploma from Military School of Mechanical Technology.

Mr. Xuewen Xiao, Director, 40, Mr. Xuewen Xiao has served as an independent Director since September 2008. Mr. Xiao has been the president of Chongqing Iron & Steel Design & Research Institute and the chairman of CISDI Engineering Co, Ltd, a state-owned company since March 2003. Mr. Xiao graduated from Tsinghua University with Master of Science degree in Mechanical Engineering in 1994.

Mr. Guoyou Zhang, Director, 57, Mr. Zhang has served as an independent Director since April 2007. Mr. Zhang is currently the Vice President of Beijing University and the director of the Institute of International Business Management, Beijing University. Professor Zhang has extensive experience in teaching economics and business management and has written and/or edited many published articles and books over the past 20 years. Mr. Zhang has been teaching in Beijing University since 1976. He received his Ph.D. degree in Economics from Beijing University in 1991.

Family Relationships

Mr. Weigang Li is the brother of Mr. Gangjin Li, Chairman of the Board.

Board Composition and Committees

Our Board has seven (7) members, of which four (4) are independent directors. We have an Audit Committee, a Compensation Committee and a Nominating and Corporate Governance Committee. The Audit Committee has been established as a separately designated standing committee in accordance with section 3(a)(58)(A) of the Exchange Act. The Audit Committee has at least one member, Mr. Albert Mclelland, who meets the definition of a "financial expert" under SEC rules and whom the Board has determined to be "independent".

Audit Committee. The Audit Committee is currently comprised of Mr. Albert Mclelland, Mr. Xianghua Li and Mr. Guoyou Zhang with Mr. Albert Mclelland as the chairman, each of whom are "independent" as that term is defined by SEC rules and under the NASDAQ listing standards. The Audit Committee is directly responsible for the appointment, retention, compensation and oversight of the work of any registered public accounting firm employed by the Company (including resolution of disagreements between management and the accounting firm regarding financial reporting) for the purpose of preparing or issuing an audit report or related work or performing other audit, review or other services. The Audit Committee has the ultimate authority and responsibility to evaluate and, where appropriate, replace the registered public accounting firm. The Audit Committee has the authority to review and approve transactions between the Company and its directors, officers and affiliates.

Compensation Committee. The Compensation Committee is responsible for the administration of all salary, bonus and incentive compensation plans for our officers and key employees. The members of the Compensation Committee are Mr. Guoyou Zhang, Mr. Xianghua Li and Mr. Xuewen Xiao, with Mr. Guoyou Zhang as the chairman. All of the members of the Compensation Committee are “independent” directors.

Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee is responsible for preparing the list of candidates to fill the expiring terms of directors on our Board of Directors. The committee submits the list of candidates to the Board of Directors who determines which candidates will be nominated to serve on the Board of Directors. The nominees are then submitted for election at the annual meeting of stockholders. The committee also submits to the entire Board of Directors, a list of candidates to fill any interim vacancies on the Board of Directors resulting from the departure of a member of the Board of Directors for any reason prior to the expiration of his term. In recommending candidates for the Board of Directors, the committee keeps in mind the functions of this body.

The committee considers various criteria, including the ability of the individual to meet SEC and NASDAQ “independence” requirements, general business experience, general financial experience, knowledge of the company’s industry (including past industry experience), education, and demonstrated character and judgment. The committee will consider director candidates recommended by a stockholder if the stockholder mails timely notice to the secretary of the Company at its principal offices, which notice includes (i) the name, age and business address of such nominee, (ii) the principal occupation of such nominee, (iii) a brief statement as to such nominee’s qualifications, (iv) a statement that such nominee consents to his or her nomination and will serve as a director if elected, (v) whether such nominee meets the definition of an “independent” director under the SEC rules and under NASDAQ listing standards and (vi) the name, address, class and number of shares of company stock held by the nominating stockholder.

Any person nominated by a stockholder for election to the Board of Directors will be evaluated based on the same criteria as all other nominees. The committee also oversees our adherence to our corporate governance standards. The members of the committee are Mr. Xuewen Xiao, Mr. Guoyou Zhang, and Mr. Xianghua Li, with Xuewen Xiao as the chairman.

The Board had 11 meetings during last fiscal year. All members attended at least 75% of the meetings.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our executive officers, directors and beneficial owners of more than ten percent (10%) to report their beneficial ownership of equity interests in the company to the SEC. Their initial reports are required to be filed using the SEC's Form 3, and they are required to report subsequent purchases, sales, and other changes using the SEC's Form 4, which must be filed within two business days of most transactions. Officers, directors, and persons owning more than 10% of our capital shares are required by SEC regulations to furnish us with copies of all of reports they file pursuant to Section 16(a).

Mr. Xiaoyuan Yuan, Principal Financial Officer of the Company, did not file the required Form 3 in a timely manner. Directors, Mr. Albert McLelland, Xuewen Xiao and Mr. Xianghua Li, did not file the required Form 3 in a timely manner. Worldtime Investment Advisors, Ltd. did not file the required Form 5 in a timely manner.

Code of Ethics

We have adopted a Code of Ethics (as defined in Item 406 of Regulation S-K) that applies to our principal executive, financial and accounting officers. China Fire & Security Group, Inc. will provide a copy of its code of ethics, without charge, to any person that requests it. Requests should be addressed in writing to Mr. Brian Lin, Chief Executive Officer, B-2508 TYG Center, C2 Dongsanhuanbeilu, Chaoyang District, Beijing 100027, People's Republic of China.

Item 11. Executive Compensation

Compensation Discussion and Analysis

The Company's executive compensation program is designed to pay key management personnel competitive remuneration based on the authority, responsibility and accountability of the position held by the individual. In addition, the Company considers the competitive environment relative to compensation paid to senior management with comparable job scopes in companies in related industries and of the same approximate size.

Our senior officers receive compensation in the form of salaries, annual bonuses and stock options. We have entered into service agreements with each of our senior officers. None of these service agreements provide benefits to our senior officers upon termination.

An understanding of our executive compensation program begins with an understanding of the objectives the program is intended to serve. These include:

- Offering competitive compensation. We seek to offer a compensation package that is attractive and competitive with the compensation practices of the peer companies with which we compete for talent.
- Rewarding performance. Our compensation program is intended to closely align executive compensation with performance by tying a significant portion of compensation to the achievement of financial and other Company goals and the executive's contributions to the accomplishment of those goals.
- Aligning the interests of our executives with those of our shareholders. Over 90% of the total compensation paid to our Named Executive Officers is in the form of equity-based compensation. This serves to further align the interests of our executives with those of our shareholders.

Elements of Our Executive Compensation Programs

Our Compensation mainly consists of two parts, Cash Compensation and Equity Incentive Compensation. The Cash Compensation consists of Base Salary and Bonus. The Equity Incentive Compensation aligns executives' and shareholders' interests by providing executives an ownership stake in the Company.

Base Salary. Base salaries for our named executives are set based on their professional qualifications and experiences, education background, scope of their responsibilities, taking into account competitive market compensation levels paid by other similar-sized companies for similar positions and reasonableness and fairness when compared to other similar positions of responsibility within the Company. Base salaries are reviewed annually by the Compensation Committee and may be adjusted annually as needed.

Bonus. To achieve our goal of pay-for-performance, bonuses will be paid to our named executives when company financial goals are achieved. The bonus is typically a percentage of the Base Salary and is part of the cash compensation of our named executives. The Compensation Committee has determined that when the Company actual financial results are better than the guidance provided by the Company, the bonuses will be paid in full. Otherwise, no bonuses will be paid to our named executives. The financial guidance was determined based on the condition of the industry and industry trends in the fire protection market and the historical financial performance of the Company. The financial guidance approved by the board of directors in fiscal year 2008 was $60.7 million in revenue and $21.8 million in net income, representing 30% growth compared to the results in fiscal year 2007. The actual financial results in 2008 were $69.1 million in revenue and $24.7 million in net income, which surpassed the financial guidance. Consequently, the bonuses to Mr. Brian Lin and Mr. Xiaoyuan Yuan were fully paid in fiscal year 2008.

Equity Incentive Compensation. A key element of our pay-for-performance philosophy is our reliance on performance-based equity awards through the Company's stock option plan. This program aligns executives' and shareholders' interests by providing executives an ownership stake in the Company. Our Compensation Committee has the authority to award equity incentive compensation, i.e. stock options, to our executive officers in such amounts and on such terms as the Compensation Committee determines in its sole discretion. The Compensation Committee reviews each executive's individual performance and his or her contribution to our strategic goals and determines the amount of stock options to be awarded towards the end of the fiscal year. The exercise price is the closing market price on the date of the grant.

The following is a discussion of our executive compensation program and the compensation decisions made for fiscal year 2008 with respect the executive officers named in the Compensation Table on page 44.

In 2008, the Compensation Committee, which is responsible for approving and overseeing executive compensation, accepted recommendations from senior management and reviewed such recommendations with market data to determine the compensation to be paid to the Company's executive officers. Important determining factors included the Company's financial performance, the level of compensation paid to similarly situated executives in comparably-sized public companies and the contributions made by each of the executive officers to the success of the Company.

How Executive Compensation is Determined

The Compensation Committee of the company seeks to offer our executives compensation packages that are attractive and competitive with compensation practices of the peer companies with which we might compete for talent. The Compensation Committee has determined that a peer company would have the following characteristics:

- majority of the business is providing solutions and systems to industrial customers in China
- listed on a major exchange in the United States with market capitalization between US$200 million to US$800 million

The Compensation Committee collected the executive compensation information of the following companies ("Comparison Group") during the course of discussing and finalizing the compensation for our executives.

	Fiscal Year 2007		
	Salary	Option	Total
1China Security & Surveillance (CSR)			
CEO	40,840	206,304	247,144
CFO	153,594	206,304	359,898
China Information Security Technology, Inc. 2(CPBY)			
CEO	45,949	369,000	414,949
CFO	60,360	-	60,360

3COGO Group, Inc. (COGO)			
CEO	30,776	271,339	302,115
CFO	125,000	752,994	877,994
4Harbin Electric, Inc. (HRBN)			
CEO	23,715	47,784	71,499
CFO	14,229	31,856	46,085
5Shengdatech, Inc. (SDTH)			
CEO	300,000	-	300,000
CFO	100,000	-	100,000
6Wonder Auto Technology, Inc. (WATG)			
CEO	90,000	-	90,000
CFO	60,000	-	60,000

	Highest	Lowest
CEO	414,949	71,499
CFO	877,994	46,085

The Compensation Committee conducted a comparison of the proposed executive compensation structure and practices to those of the Comparison Group, including base salary, target bonus and equity grants. The market analysis developed was used to determine pay targets for 2008.

In 2008, the proposed compensation for Mr. Brian Lin is as follows:

Cash Compensation:	$120,000 where the Base Salary is $84,000 (70%) and the Bonus is $36,000 (30%). The Bonus will be paid in full if the company's actually financial results meet or beat the financial guidance approved by the board of directors and released to the public. Otherwise, no Bonus will be paid to Brian Lin.
Equity Compensation:	Per stock option agreement dated July 1, 2006, 18,750 options shares will be vested during the year of 2008. There is no additional equity based compensation for Brian Lin in 2008.

In 2008, the proposed compensation for Mr. Xiaoyuan Yuan is as follows:

Cash Compensation:	$36,800 where the Base Salary is $29,440 (80%) and the Bonus is $7,360 (20%). The Bonus will be paid in full if the company's actually financial results meet or beat the financial guidance approved by the board of directors and released to the public. Otherwise, no Bonus will be paid to Xiaoyuan Yuan.
Equity Compensation:	Per stock option agreement dated July 1, 2007, 5,000 options shares will be vested during the year of 2008. There is no additional equity based compensation for Xiaoyuan Yuan in 2008.

Based on its review in 2008, the Compensation Committee concluded that the structure of CFSG's proposed compensation program is reasonably consistent with industry practices. The target parameters for the compensation of Mr. Brian Lin, our CEO and Mr. Xiaoyuan Yuan, our Principal Accounting Officer, in fiscal year 2008 were determined based on the range of compensation for the above Comparison Group. The actual compensation for Mr. Brian Lin in fiscal year 2008 was $124,000, which fell within the targeted parameters of $71,499 and $414,949 for CEOs. The actual compensation for Mr. Xiaoyuan Yuan in fiscal year 2008 was $49,900, which also fell within the targeted parameters of $46,085 to $877,944 for CFOs.

The Compensation Committee reviewed and approved the compensation paid to the named executives of the company as listed in the Compensation Table. Recommendations for annual increases in compensation to named executives other than our CEO are recommended by our CEO. These recommendations are presented to the Compensation Committee and are subject to their approval. The annual increase in compensation of the CEO was both recommended and approved by our Compensation Committee Pay increases for non-named employee will be at the discretion of the employee's supervisor and subject to senior management approval.

Stock-Based Compensation Plans

In 2008, our board of directors and shareholders adopted our 2008 stock option plan. The Plan is intended to enhance the Company's and its Affiliates' (as defined herein) ability to attract and retain highly qualified officers, directors, key employees and other persons, and to motivate such officers, directors, key employees and other persons to serve the Company and its Affiliates and to expend maximum effort to improve the business results and earnings of the Company, by providing to such persons an opportunity to acquire or increase a direct proprietary interest in the operations and future success of the Company. To this end, the Plan provides for the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, unrestricted stock and cash awards. At the time of adoption, 2,000,000 common shares were reserved for issuance under the plan. The plan has a term of ten years but may be terminated earlier by our board of directors.

We have not issued stock based compensations to any of our executives nor directors in 2008. On January 2, 2009, pursuant to the Company's 2008 Omnibus Long-term Incentive Plan, the Company's Board of Directors authorized the issuance of 1,000,000 shares of options for its employees with a total of 800,000 shares options issued to executive officers. The options will vest evenly each quarter over the following four years, starting from the first quarter of 2009.

Compensation Table

Name & Principal Position	Year	Salary	Bonus	Option* Awards	All other Compensation	Total
Gangjin Li, Chairman**	2008	$ 65,800	—	$ 8,400	—	$ 74,200
	2007	65,800	—	62,550	—	128,350
	2006	12,000	—	257,600	—	269,600
Brian Lin, CEO and PAO prior to August 2008	2008	$ 120,000	—	$ 4,200	—	$ 124,200
	2007	120,000	—	31,275	—	151,275
	2006	12,000	—	128,800	—	140,800
Xiaoyuan Yuan, Principal Accounting Officer (since August 2008)	2008	$ 36,800	—	$ 14,300	—	$ 49,900

*The assumptions made in valuing the option were disclosed in the financial statements Note 14.
**Mr. Li has not been involved in the day-to-day operation of the Company since January 2008.

Grants of Plan-Based Awards

The Company currently does not have any award plans. No options were granted to any officer in 2008.

Outstanding Equity Awards at Fiscal Year-End Table

The following table provides information concerning unexercised options, stock that has not vested, and equity incentive plan awards for our named executive officers outstanding as of December 31, 2008.

			Option Awards		
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date
Brian Lin	150,000	0		1.25	June 30, 2016
Gangjin Li	300,000	0		1.25	June 30, 2016
Xiaoyuan (Robert) Yuan	7,500	12,500		6.70	June 30, 2012

Option Exercises and Stock Vested

No options were exercised and no shares of stock were vested in 2008.

Pension Benefits

The Company does not have any pension plans for its officers.

Nonqualified Deferred Compensation

There was no nonqualified deferred compensation for the officers in 2008.

Potential Payment Upon Termination or Change in Control

The Company currently does not have payment arrangements for its officers upon termination or change in control.

Director Compensation

The following table provides information concerning compensation paid by us to our directors during the fiscal year ended December 31, 2008.

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings	All Other Compensation ($)	Total ($)
Gene Bennett (1)	20,100		5,368				25,468
Qihong Wu (1)	5,400		3,068				8,468
Yushen Liu (1)	5,400		3,068				8,468
Guoyou Zhang	14,800		3,068				17,868
Xuewen Xiao (2)	7,700						7,700
Xianghua Li (2)	5,800						5,800
Albert McLelland (2)	18,300						18,300

(1) Represents directors resigned in September 2008.

(2) Represents directors took office in September 2008.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Analysis and Discussion with the management of the Company. Based on the review and the discussions, the Compensation Committee recommended to Board of Directors that the Compensation Analysis and Discussions be included in the Company’s annual report on Form 10-K. The members of the Compensation Committee are:

Mr. Guoyou Zhang, Chairman
Mr. Xianghua Li
Mr. Xuewen Xiao

Item 12. Security Ownership Of Certain Beneficial Owners And Management And Related Shareholders Matters

The following table sets forth certain information regarding the beneficial ownership of our Common Stock, including 27,586,593 shares of Common Stock, 10,000 warrants, and 830,750 stock options that are exercisable within 60 days from March 13, 2009:

- each person who is known by us to be the beneficial owner of more than five percent (5%) of our issued and outstanding shares of Common Stock;

- each of our directors, executive officers and nominees to become directors; and

- all directors and executive officers as a group.

Title of Class	Name and Address of Beneficial Owner*	Amount and Nature of Beneficial Owner	Percent of Class
Common	Li Brothers Holding Inc.	12,768,000(1)	44.91%
Common	Vyle Investment Inc.	2,622,000(2)	9.22%
Common	China Honor Investment Limited	2,667,600(3)	9.38%
Common	Worldtime Investments Advisors Ltd.	1,976,400(4)	6.95%
Common	Gangjin Li	6,684,000(5)	23.51%
Common	Brian Lin	955,350(6)	3.36%
Common	Weishe Zhang	543,150(7)	1.91%
Common	Xiaoyuan Yuan	8,750(8)	0.03%
Common	Weigang Li	6,493,375(9)	22.84%
Common	Albert Mclelland	0	0.00%
Common	Xuewen Xiao	0	0.00%
Common	Xianghua Li	0	0.00%
Common	Guoyou Zhang	2,000(10)	0.01%
Common	Directors and executive officers as a group (9 persons)	14,686,625(11)	51.66%

* The address for the officers and directors is B-2508 TYG Center, C2 Dongsanhuanbeilu, Chaoyang District, Beijing 100027, People's Republic of China and Telephone (86-10) 8441 7400.

(1) Li Brothers Holding Inc. is a BVI company. Mr. Gangjin Li is the sole director of Li Brothers Holding Inc. with 100% of voting power and owns 50% of economic interest. Mr. Weigang Li, the brother of Mr. Gangjin Li and Vice President of Sureland Industrial, owns 50% of economic interest of Li Brothers Holding Inc.

(2) Vyle Investment Inc. is a BVI company. Mr. Brian Lin is a director of Vyle Investment Inc. with 100% of voting power and 30% ownership. Mr. Weishe Zhang holds 20% ownership.

(3) China Honor Investment Limited is a BVI company of which Mr. Ang Li, the son of Mr. Gangjin Li, has 100% ownership.

(4) Worldtime Investment Advisors Limited is a BVI company of which Ms. Huiwen Liu, sister-in-law of Mr. Brian Lin, is the sole director with 100% of voting power, but without economic interest. Mr. Zengliang Feng owns 100% of economic interest.

(5) Represents the number of shares of Common Stock plus options to purchase 300,000 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

(6) Represents the number of shares of Common Stock plus options to purchase 168,750 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

(7) Represents the number of shares of Common Stock plus options to purchase 18,750 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

(8) Represents the number of options to purchase 8,750 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

(9) Represents the number of options to purchase 109,375 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

(10) Represents the number of options to purchase 2,000 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

(11) Represents the number of options to purchase 605,625 shares of Common Stock that is exercisable within 60 days from March 13, 2009.

Item 13. Certain Relationships And Related Transactions and Director Independence

The Company has accounts receivable from Hubei Shou An Changjiang Fire Protection Co., Ltd. ("Hubei Shou An"), in which the Company has 19% ownership interest. The receivable due from Hubei Shou An was $466,223 as of December 31, 2008.

Item 14. Principal Accounting Fees And Services

Moore Stephens Wurth Frazer and Torbet, LLP has audited our financial statements annually since the 2004 fiscal year. All of the services described below were approved by our board and audit committee prior to performance. The board has determined that the payments made to its independent accountant for these services are compatible with maintaining such auditor's independence.

Audit Fees

The aggregate fees for professional services rendered by Moore Stephens Wurth Frazer and Torbet, LLP in connection with its audit of our internal control over financial reporting, audit of our annual consolidated financial statements in our Form 10-K or 10-KSB and the review of our quarterly consolidated financial statements included in our Forms 10-Q or 10-QSB for the fiscal years ended December 31, 2008, 2007 and 2006 totaled approximately $305,000, $245,000 and $180,000 respectively.

Audit-Related Fees

No fees were paid or accrued by us for assurance and related services rendered by Moore Stephens Wurth Frazer and Torbet, LLP in connection with its audit and review of our financial statements for the fiscal years ended December 31, 2008, 2007 and 2006.

Tax Fees

$10,000 and $5,000 were paid or accrued by us for professional services rendered by Moore Stephens Wurth Frazer and Torbet, LLP for tax compliance, tax advice and tax planning for the fiscal years December 31, 2008 and 2007, respectively, and no fee were paid or accrued for the fiscal years ended December 31, 2006.

All Other Fees

No fees were paid or accrued by us for other services rendered by Moore Stephens Wurth Frazer and Torbet, LLP for the fiscal years ended December 31, 2008, 2007 and 2006.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) The Following financial statements are included in this Annual Report on Form 10-K commencing on the page numbers specified below

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets at December 31, 2008 and 2007	F-2
	F-3

Consolidated Statements of Income and Other Comprehensive Income for the Years Ended December 31, 2008, 2007 and 2006	
Consolidated Statements of Shareholders' equity	F-4
Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006	F-5
Notes to Consolidated Financial Statements	F-6

(2) Financial Statement Schedules

None

(3) Exhibits

The exhibits listed on the Exhibit Index (following the Financial Statements of this report) are included, or incorporated by reference, in this annual report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant certifies that it has duly caused this Annual Report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized, in Beijing.

CHINA FIRE & SECURITY GROUP, INC.

Dated: October 30, 2009

By: /s/ Brian Lin
Brian Lin
Chief Executive Officer,

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K/A has been signed by the following persons in the capacities indicated as of October 30, 2009.

Signature	Title
/s/ Gangjin Li Gangjin Li	Chairman of the Board
/s/ Brian Lin Brian Lin	Director and Chief Executive Officer
/s/ Xiaoyuan Yuan Xiaoyuan Yuan	Principal Accounting Officer and Principal Financial Officer
/s/ Weishe Zhang Weishe Zhang	Director and Chief Technology Officer
/s/ Albert McLelland Albert McLelland	Director

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
China Fire & Security Group, Inc.

We have audited the accompanying consolidated balance sheets of China Fire & Security Group, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income and other comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008. China Fire & Security Group, Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Fire & Security Group, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), China Fire & Security Group, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 16, 2009 expressed an adverse opinion.

/s/ Moore Stephens Wurth Frazer and Torbet, LLP

Walnut California
October 30, 2009

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2008 AND 2007

	December 31, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 26,655,333	$ 17,110,449
Restricted cash	5,377,933	3,829,927
Notes receivable	3,670,259	3,315,811
Accounts receivable, net of allowance for doubtful accounts of $4,370,362 and $2,483,359 as of December 31, 2008 and 2007, respectively	25,826,343	16,525,161
Receivables from related party	466,223	-
Other receivables	1,532,259	748,195
Inventories	6,538,938	4,048,283
Costs and estimated earnings in excess of billings	17,821,708	13,068,036
Employee advances	743,868	1,326,115
Prepayments and deferred expenses	2,816,976	2,218,391
Total current assets	91,449,840	62,190,368
PLANT AND EQUIPMENT, net	8,445,254	6,568,250
OTHER ASSETS:		
Restricted cash - non current	1,872,828	-
Accounts receivable - retentions	1,107,450	193,029
Deferred expenses - non current	-	21,234
Advances on building and equipment purchases	249,859	366,317
Investment in joint ventures	1,167,238	1,156,294
Intangible assets, net of accumulated amortization	1,116,449	1,150,935
Total other assets	5,513,824	2,887,809
Total assets	$ 105,408,918	$ 71,646,427
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 6,664,090	$ 6,327,182
Customer deposits	6,102,026	4,757,179
Billings in excess of costs and estimated earnings	4,237,528	4,882,217
Other payables	837,973	168,868
Accrued liabilities	6,785,409	4,214,530
Taxes payable	2,092,745	1,088,335
Total current liabilities	26,719,771	21,438,311
COMMITMENTS AND CONTINGENCIES	-	-
SHAREHOLDERS' EQUITY:		

Common stock, $0.001 par value, 65,000,000 shares authorized, 27,586,593 shares and 27,556,893 issued and outstanding as of December 31, 2008 and 2007, respectively	27,586	27,556
Additional paid-in-capital	19,357,409	19,317,287
Statutory reserves	7,148,827	5,067,061
Retained earnings	44,850,181	22,228,095
Accumulated other comprehensive income	7,305,144	3,568,117
Total shareholders' equity	78,689,147	50,208,116
Total liabilities and shareholders' equity	$ 105,408,918	$ 71,646,427

See report of independent registered public accounting firm.
The accompanying notes are an integral part of this statement.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	2008	2007	2006
REVENUES			
System contracting projects	$ 57,101,984	$ 34,581,376	$ 24,008,170
Products	9,673,922	10,592,683	7,701,986
Maintenance services	2,303,213	1,579,778	744,880
Total revenues	69,079,119	46,753,837	32,455,036
COST OF REVENUES			
System contracting projects	25,805,086	16,158,844	12,893,082
Products	2,558,844	4,329,067	3,272,438
Maintenance services	1,217,316	602,943	60,787
Total cost of revenues	29,581,246	21,090,854	16,226,307
GROSS PROFIT	39,497,873	25,662,983	16,228,729
OPERATING EXPENSE			
Selling and marketing	6,434,887	3,907,067	2,827,838
General and administrative	6,680,992	5,661,356	3,665,776
Depreciation and amortization	712,269	535,751	498,499
Research and development	2,102,976	672,379	1,258,172
Total operating expense	15,931,124	10,776,553	8,250,285
INCOME FROM OPERATIONS	23,566,749	14,886,430	7,978,444
OTHER INCOME (EXPENSE)			
Other income	929,919	581,192	738,680
Other expense	(127,620)	(14,932)	(43,323)
Interest income	382,227	148,236	28,038
Interest expense	-	-	(79,417)
Change in fair value of derivative instruments	-	1,205,791	(1,570,575)
Total other income (expense)	1,184,526	1,920,287	(926,597)
INCOME BEFORE PROVISION FOR INCOME TAXES	24,751,275	16,806,717	7,051,847
PROVISION FOR INCOME TAXES	47,423	5,081	82,206
NET INCOME	24,703,852	16,801,636	6,969,641
OTHER COMPREHENSIVE INCOME			
Foreign currency translation adjustment	3,737,027	2,502,595	581,932
COMPREHENSIVE INCOME	$ 28,440,879	$ 19,304,231	$ 7,551,573
BASIC EARNINGS PER SHARE			

Weighted average number of shares	27,568,214	26,873,742	24,340,196
Earnings per share	$ 0.90	$ 0.63	$ 0.29
DILUTED EARNINGS PER SHARE			
Weighted average number of shares	28,210,620	27,721,171	24,539,414
Earnings per share	$ 0.88	$ 0.61	$ 0.28

See report of independent registered public accounting firm.
The accompanying notes are an integral part of this statement.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock Shares	Common Stock Par value	Additional paid-in-capital	Retained Earnings Statutory reserves	Retained Earnings Unrestricted	Owner contribution receivable	Accumulated other comprehensive income	Totals
BALANCE, December 31, 2005	24,000,000	$ 24,000	$ 6,056,058	$ 3,458,325	$ 65,554	$ (10,087,527)	$ 483,590	$ -
Net income					6,969,641			6,969,641
Collection of contribution receivable			4,973			10,087,527		10,092,500
Cash proceeds from investment in Sureland Equipment Co., Ltd			660,000					660,000
Issuance of common stock	2,461,678	2,462	6,028,140					6,030,602
Options issued to employees			644,000					644,000
Adjustment to statutory reserves				572,302	(572,302)			-
Foreign currency translation adjustment							581,932	581,932
BALANCE, December 31, 2006	26,461,678	$ 26,462	$ 13,393,171	$ 4,030,627	$ 6,462,893	$ -	$ 1,065,522	$ 24,978,675
Net income					16,801,636			16,801,636
Warrants reclassified from liabilities			1,475,020					1,475,020
Issuance of common stock	984,680	983	4,164,214					4,165,197

Warrants exercised	110,535	111	(111)					-
Warrants issued for services			94,274					94,274
Options issued to employees			190,719					190,719
Adjustment on registered capital				(605,000)	605,000			-
Adjustment on statutory reserves				1,641,434	(1,641,434)			-
Foreign currency translation adjustment							2,502,595	2,502,595
BALANCE, December 31, 2007	27,556,893	$ 27,556	$ 19,317,287	$ 5,067,061	$ 22,228,095	$ -	$ 3,568,117	$ 50,208,116
Net income					24,703,852			24,703,852
Warrants exercised	29,700	30	(30)					-
Options issued to employees			40,152					40,152
Adjustment on statutory reserves				2,081,766	(2,081,766)			-
Foreign currency translation adjustment							3,737,027	3,737,027
BALANCE, December 31, 2008	27,586,593	$ 27,586	$ 19,357,409	$ 7,148,827	$ 44,850,181	$ -	$ 7,305,144	$ 78,689,147

See report of independent registered public accounting firm.
The accompanying notes are an integral part of this statement.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 24,703,852	$ 16,801,636	$ 6,969,641
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	728,080	555,604	526,240
Amortization	75,041	54,257	13,041
Provision for doubtful accounts	1,683,336	1,111,051	691,242
(Gain) Loss on disposal of equipment	(35,689)	17,715	23,635
Stock compensation to employees	40,152	190,719	644,000
Warrants issued for services	-	94,274	-
Change in fair value of derivative instruments	-	(1,205,791)	1,570,575
Provision for estimated warranty claims	518,940	-	-
Change in operating assets and liabilities			
Notes receivable	(120,143)	(2,256,606)	377,087
Accounts receivable	(10,571,077)	(3,206,458)	(6,222,846)
Receivables from related party	(458,119)	-	-
Other receivables	(718,956)	182,485	69,393
Inventories	(2,168,821)	416,317	(1,664,322)
Costs and estimated earnings in excess of billings	(3,771,899)	(3,286,191)	(3,125,106)
Employee advances	663,369	419,589	(272,928)
Prepayments and deferred expenses	(412,888)	334,603	(621,609)
Accounts payable	(98,219)	(117,311)	2,015,302
Customer deposits	994,154	1,781,869	928,949
Billings in excess of costs and estimated earnings	(969,403)	(4,418,793)	5,635,038
Other payables	645,855	(287,672)	(100,911)
Accrued liabilities	1,722,071	2,168,961	1,483,068
Taxes payable	912,068	422,856	(4,428)
Net cash provided by operating activities	13,361,704	9,773,114	8,935,061
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of plant and equipment	(2,015,051)	(3,419,056)	(583,208)
Advances on building and equipment purchase	-	(351,809)	-
Proceeds from sale of equipment	69,852	20,820	22,979
Purchase of intangible assets	-	(613,582)	-
Payments for investment in Hubei Sureland Changjiang Fire Safety Technology Co., Ltd.	-	(150,104)	-
Payments for investment in King Galaxy Investments Limited	-	(1,000,000)	-
Payments for acquisition of Sureland Industrial assets	-	-	(10,087,527)
Payments for investment in Tianjin Fire Safety Equipment Co., Ltd.	-	-	(301,996)
Proceeds from sale of investment in Tianjin Fire Safety Equipment Co., Ltd.	-	514,856	-
Proceeds from sale of Beijing Zhong Xiao Fire Safety Technology Co., Ltd	-	1,068,897	-

Net cash used in investing activities	(1,945,199)	(3,929,978)	(10,949,752)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Change in restricted cash	(3,097,855)	(2,011,480)	(35,017)
Dividend distributions to original shareholders and minority interest shareholders			(8,886,800)
Payments on notes payables	-	-	(2,532,000)
Proceeds from note payables	-	-	2,496,000
Proceeds from increase in paid-in capital	-	-	660,000
Proceeds from original shareholders	-	-	10,092,500
Payments to Beijing Zhong Xiao Fire Safety Technology Co., Ltd.	-	(2,466,395)	-
Proceeds from Beijing Zhong Xiao Fire Safety Technology Co., Ltd	-	1,364,630	-
Proceeds from issuance of common stock	-	4,165,197	7,140,838
Net cash (used in) provided by financing activities	(3,097,855)	1,051,952	8,935,521
EFFECT OF EXCHANGE RATE CHANGES ON CASH	1,226,234	789,270	147,862
INCREASE IN CASH	9,544,884	7,684,358	7,068,692
CASH and CASH EQUIVALENTS, beginning of year	17,110,449	9,426,091	2,357,399
CASH and CASH EQUIVALENTS, end of year	$ 26,655,333	$ 17,110,449	$ 9,426,091
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Income taxes paid	$ 29,048	$ 46,390	$ 147,822
Interest paid	$ -	$ -	$ 79,025
NON-CASH TRANSACTIONS INVESTING AND FINANCING ACTIVITIES:			
Reclassification of warrant liability to paid-in capital upon modification of warrants agreement	$ -	$ 1,475,020	$ -
Reclassification of advances on building and equipment purchase to plant and equipment upon receipt of purchase	$ 139,638	$ -	$ -

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The accompanying notes are an integral part of this statement.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

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Note 1 - Background

China Fire & Security Group Inc. (the “Company”), is a Florida corporation. The Company, through its subsidiaries, is engaged in the design, development, manufacture and sale of fire protection products and services for industrial customers in China.

Note 2 - Summary of significant accounting policies

The reporting entity

The consolidated financial statements of China Fire & Security Group Inc. and subsidiaries reflect the activities of the parent and the following subsidiaries:

Subsidiaries	Incorporated in	Ownership Percentage
China Fire Protection Group Inc(“CFPG”)	British Virgin Islands	100%
Sureland Industrial Fire Safety Limited (“Sureland Industrial”)	People’s Republic of China	100%
Sureland Industrial Fire Equipment Co. Ltd (“Sureland Equipment”)	People’s Republic of China	100%
Tianxiao Fire Safety Equipment Co., Ltd. (“Tianxiao Equipment”)	People’s Republic of China	100%
Beijing Hua An Times Fire Safety Technology Co., Ltd. (“Beijing Hua An”)	People’s Republic of China	100%

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All material intercompany transactions and balances have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles of the United States of America requires management to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Management believes that the estimates utilized in preparing its financial statements are reasonable and prudent. Actual results could differ from these estimates.

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Certain of the Company’s accounting policies require higher degrees of judgment than others in their application. These include the recognition of revenue and earnings from system contracting projects under the percentage of completion method, determining the fair value of stock based compensation and the allowance of doubtful accounts. Management evaluates all of its estimates and judgments on an on-going basis.

Revenue recognition

Revenue is recognized when it is probable that the economic benefits will flow to the Company as follows:

1. Revenue from system contracting projects are recognized using the percentage-of-completion method of accounting and, therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that cost expended to date bears to anticipated final total cost, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer or in accordance with paragraphs 62 and 65 of the AICPA’S Statement of Position ("SOP") 81-1, "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1").

2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue is presented net of a value-added tax (VAT). All of the Company’s products that are sold in the People’s Republic of China (“PRC”) are subject to a Chinese value-added tax at a rate of 17% of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing their finished product.

3. Revenue from the rendering of Maintenance Services is recognized over the service period on a straight line basis.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

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In accordance with SFAS 48, “Revenue Recognition when Right of Return Exists,” revenue is recorded net of an estimate of markdowns, price concessions and warranty costs. Such reserve is based on management’s evaluation of historical experience, current industry trends and estimated costs.

Enterprise Wide Disclosure

Almost all the Company’s products (fire detecting products, fire alarm control device, and water mist/sprinkler systems) are sold via system contracting projects or as part of the integrated products sales. The composition of these three types of products varies significantly from project to project, both in quantity and in dollar amounts. Although the Company could provide a breakdown of sales contribution for our own products for each project, it is almost impossible to provide revenues for each of our products when the revenue from each project is recognized based on percentage of completion. More importantly, the revenues from the Company’s own products do not accurately reflect our overall financial performance. The Company is a system contracting projects provider rather than product vendors who sell their own products directly or through channels. Therefore, it is not practical to separately disclose the revenues from external customers for each of our products.

The Company’s chief operating decision-makers (i.e. chief executive officer and his direct reports) review financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by business lines for purposes of allocating resources and evaluating financial performance. There are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Based on qualitative and quantitative criteria established by SFAS 131, “Disclosures about Segments of an Enterprise and Related Information”, the Company considers itself to be operating within one reportable segment.

Shipping and handling

Costs related to shipping and handlings are included in cost of revenue pursuant to EITF 00-10 “Accounting for Shipping and Handling Fees and Costs.”

Foreign currency translation

The reporting currency of the Company is the US dollar. The Company uses their local currency, Renminbi (RMB), as their functional currency. Results of operations and cash flow are translated at average exchange rates during the period, and assets and liabilities are translated at the unified exchange rate as quoted by the People’s Bank of China at the end of the period. Translation adjustments resulting from this process are included in accumulated other comprehensive income in the statement of shareholders’ equity.

Translation adjustments amounted to $7,305,144 and $3,568,117 as of December 31, 2008 and 2007, respectively. Asset and liability accounts at December 31, 2008 were translated at 6.82 RMB to $1.00 as compared to 7.29 RMB at December 31, 2007. Equity accounts were stated at their historical rate. The average translation rates applied to income statements accounts for the years ended December 31, 2008, 2007 and 2006 were 6.94 RMB, 7.59 RMB and 7.96 RMB, respectively. Cash flows are also translated at average translation rates for the period, therefore, amounts reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

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Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred. Historically, the Company has not entered any currency trading or hedging transactions, although there is no assurance that the Company will not enter into such transactions in the future.

Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets with 5% residual value. For the years ended December 31, 2008, 2007 and 2006, depreciation expense amounted to $728,080, $555,604, and $526,240 respectively.

Estimated useful lives of the assets are as follows:

	Useful Life
Buildings and improvements	40 years
Transportation equipment	5 years
Machinery	10 years
Office equipment	5 years
Furniture	5 years

Construction in progress represents the costs incurred in connection with the construction of buildings or additions to the Company's plant facilities. No depreciation is provided for construction in progress until such time as the assets are completed and placed into service.

The cost and related accumulated depreciation of assets sold or otherwise retired are eliminated from the accounts and any gain or loss is included in the statements of income. Maintenance, repairs and minor renewals are charged directly to expense as incurred. Major additions and betterment to buildings and equipment are capitalized.

Long-term assets of the Company are reviewed periodically or more often if circumstances dictate, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company evaluates the periods of depreciation and amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of December 31, 2008, the Company expects these assets to be fully recoverable.

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Plant and equipment consist of the following:

	December 31, 2008	December 31, 2007
Buildings and improvements	$ 6,417,304	$ 5,077,373
Transportation equipment	2,747,038	1,985,701
Machinery	1,249,470	970,500
Office equipment	1,262,426	1,047,350
Furniture	90,882	35,972
Total	11,767,120	9,116,896
Less accumulated depreciation	(3,321,866)	(2,548,646)
Plant and equipment, net	$ 8,445,254	$ 6,568,250

Concentration of risk

Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the People’s Republic of China and Hong Kong. The Company maintains balances at financial institutions which, from time to time, may exceed Hong Kong Deposit Protection Board insured limits for the banks located in Hong Kong. Balances at financial institutions or state owned banks within the PRC are not covered by insurance. As of December 31, 2008 and 2007, the Company had deposits (including restricted cash balances) totaling to $30,765,488 and $20,940,016, that are not covered by insurance, respectively. The Company has not experienced any losses in such accounts and believes it is not exposed to any risks on its cash in bank accounts.

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in the North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

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The Company has one major customer who represents approximately 25% of the Company's sales for the year ended December 31, 2008. Accounts receivable from this customer was $0 as of December 31, 2008. The Company had one major customer who represents approximately 20% of the Company's sales for the year ended December 31, 2007. Accounts receivable from this customer was $266,660 as of December 31, 2007.

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents are carried at cost, which approximates at its market value. Cash and cash equivalents also include unrestricted time deposits.

Restricted cash

Restricted cash represents cash required to be deposited in a separate bank account subject to withdrawal restrictions by its system contracting projects and product sales customers to guarantee its contracts will be performed. The deposit cannot be drawn or transferred by the Company until the restriction period has expired.

	December 31, 2008	December 31, 2007
Restricted cash		
Products sales	$ 1,608,056	$ 102,355
System contracting projects	5,642,705	3,727,572
Total restricted cash	7,250,761	3,829,927
Restricted cash - non current	(1,872,828)	-
Restricted cash - current	$ 5,377, 933	$ 3,829,927

Inventories

Inventories are stated at the lower of cost or market, using weighted average method. Inventories consisted of the following as of December 31,

	2008	2007
Raw materials	$ 896,797	$ 310,255
Finished goods	4,597,407	2,617,638
Work in progress	1,044,734	1,120,390
Total	$ 6,538,938	$ 4,048,283

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Raw materials consist primarily of materials used in production. Finished goods consist primarily of equipment used in product sales and system contracting projects. The costs of finished goods include direct costs of raw materials as well as direct labor used in production. Indirect production costs such as utilities and indirect labor related to production such as assembling, shipping and handling costs are also included in the cost of inventory. The Company reviews its inventories periodically to determine if any reserves are necessary for potential obsolescence. As of December 31, 2008 and 2007, the Company determined no reserves are necessary.

Accounts receivable

Accounts receivable represents amounts due from customers for products sales, maintenance services and system contracting projects. Overdue balances are reviewed regularly by senior management. Reserves are recorded when collection of amounts due are in doubt. Delinquent account balances are written-off after management has determined that the likelihood of collection is not probable, known bad debts are written off against allowance for doubtful accounts when identified.

Accounts receivable consists of the following:

	December 31, 2008	December 31, 2007
Accounts receivable:		
System contracting projects	$ 19,167,096	$ 10,296,762
Maintenance services	3,193,166	670,357
Products sales	8,943,893	8,234,430
Total accounts receivable	31,304,155	19,201,549
Allowance for bad debts	(4,370,362)	(2,483,359)
Accounts receivable, net	26,933,793	16,718,190
Accounts receivable - non-current retentions	(1,107,450)	(193,029)
Accounts receivable - current	$ 25,826,343	$ 16,525,161

The activity in the allowance for doubtful accounts for trade accounts receivable for the years ended December 31, 2008 and 2007 is as follows:

	2008	2007
Beginning allowance for doubtful accounts	$ 2,483,359	$ 1,252,947
Additional charged to bad debt expense	1,683,336	1,111,051
Write-off charged against the allowance	-	(12,700)
Foreign currency translation adjustment	203,667	132,061
Ending allowance for doubtful accounts	$ 4,370,362	$ 2,483,359

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Retentions held by customers of system contracting projects included in the Company's accounts receivable as following:

	December 31, 2008	December 31, 2007
Retentions		
Current	$ 3,685,136	$ 2,829,250
Non-current	1,107,450	193,029
Total retentions	$ 4,792,586	$ 3,022,279

These balances represent portions of billings made by the Company but held for payment by the customer pending satisfactory completion of the project. Retention payments are generally collected within one year of the completion of the project.

Costs and estimated earnings in excess of billings

The current asset, "Costs and estimated earnings in excess of billings" on contracts, represents revenues recognized in excess of amounts billed.

	December 31, 2008	December 31, 2007
Contract costs incurred plus recognized profits less recognized losses to date	$ 68,149,817	$ 50,877,880
Less: progress billings	50,328,109	37,809,844
Costs and estimated earnings in excess of billings	$ 17,821,708	$ 13,068,036

Billings in excess of costs and estimated earnings

The current liability, "Billings in excess of costs and estimated earnings" on contracts, represents billings in excess of revenues recognized.

	December 31, 2008	December 31, 2007
Progress billings	$ 31,456,807	$ 15,713,786
Less: contracts costs incurred plus recognized profits less recognized losses to date	27,219,279	10,831,569
Billings in excess of costs and estimated earnings	$ 4,237,528	$ 4,882,217

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Research and development

Research and development expenses include salaries, consultant fees, supplies and materials, as well as costs related to other overhead such as depreciation, facilities, utilities and other departmental expenses. The costs we incur with respect to internally developed technology and engineering services are included in research and development expenses as incurred as they do not directly relate to any particular licensee, license agreement or licenses fee.

Warranty

Generally, the Company's products are not covered by specific warranty terms. However, it is the Company's policy to replace parts if they become defective within one year after deployment at no additional charge. The Company maintains a provision for potential warranty costs on these products for one year. This provision represents management's assessment of our history of warranty costs while incorporating estimates by our quality review staff of our potential product failure rates. The Company records a warranty obligation in selling expense at the time of revenue are recognized. For the years ended December 31, 2008, 2007 and 2006, the Company made $518,940, $0 and $0, respectively, provision for estimated warranty claims for our products.

Fair value of financial instruments

On January 1, 2008, the Company adopted SFAS 157, Fair Value Measurements, which defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosures requirements for fair value measures. The carrying amounts reported in the balance sheets for current assets and current liabilities qualify as financial instruments and are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels are defined as follow:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

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The Company invested $167,238 (RMB 1,140,000) to Hubei Shou An Changjiang Fire Protection Co., Ltd for 19% ownership and invested $1,000,000 to King Galaxy Investments Limited for 5% ownership. Total investment as of December 31, 2008 amounted to $1,167,238. Since there is no quoted or observable market price for the fair value of similar long term in joint venture, the Company then used the level 3 inputs for its valuation methodology. The determination of the fair value was based on the cost of the capital contribution to the joint ventures.

The Company did not identify any other assets and liabilities that are required to be presented on the balance sheet at fair value in accordance with SFAS 157.

Intangible assets

Land use rights - All land in the People's Republic of China is owned by the government. However, the government grants the user "land use rights". The Company acquired land use rights in 2001 and the land use rights expire in 2051. The costs of these rights are being amortized over fifty years using the straight-line method.

Technology rights - In May 2007, the Company acquired two technology rights to manufacture fire protection products for and the costs of these rights are being amortized over ten years using the straight-line method

	December 31, 2008	December 31, 2007
Land use rights	$ 770,789	$ 720,445
Technology rights	608,745	608,745
Accumulated amortization	(263,085)	(178,255)
Balance	$ 1,116,449	$ 1,150,935

Amortization expense amounted to $75,041, $54,257, and $13,041 for the years ended December 31, 2008, 2007 and 2006, respectively.

Intangible assets of the Company are reviewed annually, more often when circumstances require, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company also evaluates the periods of amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of December 31, 2008, the Company expects these assets to be fully recoverable.

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Income taxes

The Company reports income taxes pursuant to SFAS 109, "Accounting for Income Taxes". SFAS 109 requires the recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consist of taxes currently due plus deferred taxes. There are no deferred tax amounts at December 31, 2008 and December 31, 2007.

The Company adopted FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. The adoption had no affect on the Company's financial statements.

The Company's operations are subject to income and transaction taxes in the United States and in the PRC jurisdictions. Significant estimates and judgments are required in determining the Company's worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result.

The Company does not anticipate any events which could cause change to these uncertainties.

The charge for taxation is based on the results for the year as adjusted for items, which are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of assessable tax profit.

In principal, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probably that taxable profit will be available against which deductible temporary differences can be utilized. Deferred tax is calculated using tax rates that are expected to apply to the period when the asset is realized or the liability is settled. Deferred tax is charged or credited in the income statement, except when it is related to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

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Value Added Tax

Enterprises or individuals who sell products, engage in repair and maintenance or import and export goods in the PRC are subject to a value added tax in accordance with Chinese laws. The value added tax standard rate is 17% of the gross sales price. A credit is available whereby VAT paid on the purchases of semi-finished products or raw materials used in the contract and production of the Company’s finished products can be used to offset the VAT due on sales of the finished product.

VAT on sales and VAT on purchases amounted to $6,941,766 and $5,183,036 for the year ended December 31, 2008, $6,279,253 and $4,485,292 for the year ended December 31, 2007, and $2,501,949 and $3,258,567 for the year ended December 31, 2006, respectively. Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Stock based compensation

The Company adopted SFAS 123R “Accounting for Stock-Based Compensation” at the beginning of 2006, which defines a fair-value-based method of accounting for stock based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with SFAS 123R and the EITF. 96-18, "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services", as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

Recently issued accounting pronouncements

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115. SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Company adopted SFAS 159 on January 1, 2008. The Company chose not to elect the option to measure the fair value of eligible financial assets and liabilities.

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In June 2007, the FASB issued FASB Staff Position No. EITF 07-3, “Accounting for Nonrefundable Advance Payments for Goods or Services Received for use in Future Research and Development Activities” (“FSP EITF 07-3”), which addresses whether nonrefundable advance payments for goods or services that used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed. FSP EITF 07-3 was effective beginning in 2008. The adoption of FSP EITF 07-3 did not impact our consolidated financial statements.

In December 2007, the FASB issued SFAS 160, “Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51”, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company has not determined the effect that the application of SFAS 160 will have on its consolidated financial statements.

In December 2007, SFAS 141(R), “Business Combinations”, was issued. SFAS 141R replaces SFAS No. 141, Business Combinations. SFAS 141R retains the fundamental requirements in SFAS 141 that the acquisition method of accounting, which SFAS 141 called the purchase method, be used for all business combinations and for an acquirer to be identified for each business combination. SFAS 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This replaces SFAS 141’s cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. SFAS 141R also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141R). SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The Company is currently evaluating the impact that adopting SFAS 141R will have on its financial statements.

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In March 2008, the FASB issued SFAS 161, “Disclosures about Derivative Instruments and Hedging Activities - An Amendment of SFAS No. 133”. Effective on January 1, 2009, SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. To achieve this increased transparency, SFAS 161 requires (1) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (2) the disclosure of derivative features that are credit risk-related; and (3) cross-referencing within the footnotes. The Company is in the process of evaluating the new disclosure requirements under SFAS 161.

In May 2008, the FASB issued SFAS 162, "The Hierarchy of Generally Accepted Accounting Principles". FAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is in the process of evaluating the impact of adoption of this statement on the results of operations, financial position or cash flows.

In June 2008, the FASB issued EITF 07-5 “Determining whether an Instrument (or Embedded Feature) is indexed to an Entity’s Own Stock”. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS 133 specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company’s own stock and (b) classified in stockholders’ equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer’s own stock and thus able to qualify for the SFAS 133 paragraph 11(a) scope exception. This standard will triggered liability accounting on all options and warrants exercisable at strike prices denominated in any currency other than the functional currency of the operating entity in China (Renminbi). The Company is currently evaluating the impact of the adoption of EITF 07-5 on the Company’s consolidated financial statements.

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In June 2008, FASB issued EITF 08-4, “Transition Guidance for Conforming Changes to Issue No. 98-5”. The objective of EITF 08-4 is to provide transition guidance for conforming changes made to EITF 98-5, “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios”, that result from EITF 00-27 “Application of Issue No. 98-5 to Certain Convertible Instruments”, and SFAS 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”. This Issue is effective for financial statements issued for fiscal years ending after December 15, 2008. Early application is not permitted. Management is currently evaluating the impact of adoption of EITF 08-4 on the accounting for the convertible notes and related warrants transactions.

On October 10, 2008, the FASB issued FSP 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active,” which clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 became effective on October 10, 2008, and its adoption did not have a material impact on our financial position or results.

In January 2009, the FASB issued FSP EITF 99-20-1, “Amendments to the Impairment Guidance of EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets”. FSP EITF 99-20-1 changes the impairment model included within EITF 99-20 to be more consistent with the impairment model of SFAS No. 115. FSP EITF 99-20-1 achieves this by amending the impairment model in EITF 99-20 to remove its exclusive reliance on “market participant” estimates of future cash flows used in determining fair value. Changing the cash flows used to analyze other-than-temporary impairment from the “market participant” view to a holder’s estimate of whether there has been a “probable” adverse change in estimated cash flows allows companies to apply reasonable judgment in assessing whether an other-than-temporary impairment has occurred. The adoption of FSP EITF 99-20-1 did not have a material impact on our consolidated financial statements because all of our investments in debt securities are classified as trading securities.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications have no effect on net income or cash flows.

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Note 3 - Earnings per share

The Company reports earnings per share in accordance with the provisions of SFAS 128, "Earnings per Share." SFAS 128 requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

The following is a reconciliation of the basic and diluted earnings per share computation for the years ended December 31:

	2008	2007	2006
Net income for earnings per share	$ 24,703,852	$ 16,801,636	$ 6,969,641
Weighted average shares used in basic computation	27,568,214	26,873,742	24,340,196
Diluted effect of stock options and warrants	642,406	847,429	199,218
Weighted average shares used in diluted computation	28,210,620	27,721,171	24,539,414
Earnings per share:			
Basic	$ 0.90	$ 0.63	$ 0.29
Diluted	$ 0.88	$ 0.61	$ 0.28

At December 31, 2008 and 2007, all outstanding stock options and warrants were included in the calculation of diluted earnings per share. At December 31, 2006, 1,169,306 warrants were excluded from the calculation because of their antidilutive nature.

Note 4 – Related party transactions

The Company has accounts receivable from Hubei Shou An Changjiang Fire Protection Co., Ltd. ("Hubei Shou An"), in which the Company has 19% ownership interest. The receivable due from Hubei Shou An was $114,388 and $0 as of December 31, 2008 and 2007, respectively. This balance was resulted from product sales totaling $96,068 plus 17% VAT of $19,408 and resulted in translation loss of $1,088. This amount was expected to be repaid by December 31, 2009 in cash. ..

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The Company has other receivable from Hubei Shou An, in which the Company has 19% ownership interest. The receivable due from Hubei Shou An was $351,835 and $0 as of December 31, 2008 and 2007, respectively. This balance was for the operating capital in Hubei Shou An and expected to be repaid by June 30, 2009 in cash.

Note 5 - Notes receivable

Notes receivable represents trade accounts receivable due from various customers where the customers' bank has guaranteed the payment of the receivable. This amount is non-interest bearing and is normally paid within three to six months. The Company has the ability to submit their request for payment to the customer's bank earlier than the scheduled payment date. However, the Company will incur an interest charge and a processing fee when they submit the payment request early. The Company's notes receivable totaled $3,670,259 and $3,315,811 as of December 31, 2008 and 2007, respectively.

Note 6 - Prepayments and deferred expenses

Prepayments and deferred expenses are monies deposited with or advanced to subcontractors to perform services on System Contracting Projects. Some subcontractors require a certain amount of money to be deposited as a guarantee payment in order for them start performing the services. Prepayments and deferred expenses also include monies deposited or advanced to vendors on future inventory purchases to ensure timely delivery. The total outstanding amount was $2,816,976 and $2,218,391 as of December 31, 2008 and 2007, respectively.

Note 7 - Investment in joint ventures

During the second quarter of 2007, the Company invested $167,238 (RMB 1,140,000) for a 19% interest in Hubei Shou An Changjiang Fire Protection Co., Ltd., located in China Hubei, PRC. The investment is recorded under the cost accounting method.

During the third quarter of 2007, the Company invested $1,000,000 for a 5% interest in King Galaxy Investments Limited. King Galaxy through its wholly owned subsidiary, China Alliance Security Holdings Company Limited owns 100% of Wan Sent (China) Technology Co., Ltd. ("Wan Sent"), an emerging Chinese fire emergency remote-monitoring system provider based in Beijing, PRC. The investment has been recorded under the cost accounting method.

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Note 8 - Customer deposits

Customer deposits represent amounts advanced by customers on products orders and maintenance services deposits and system contracting projects deposits. The product or service normally is shipped or performed within six months after receipt of the advance payment and the related sale is recognized in accordance with the Company's revenue recognition policy. Customer deposits also represent amounts advanced by customers on system contracting projects deposits. The advance payment will apply to the invoices when the Company billed our customer based on the progression of the projects. As of December 31, 2008 and 2007, customer deposits amounted to $6,102,026 and $4,757,179, respectively.

Note 9 - Accrued liabilities

Accrued liabilities represent subcontractors' expenses incurred as of balance sheet date for system contracting projects. Accrued liabilities also represent accrued estimation of warranty expenses. As of December 31, 2008 and 2007, accrued liabilities amounted to $6,785,409 and $4,214,530, respectively.

Note 10 - Income taxes

Prior to January 1, 2008, under the Income Tax Laws of PRC, the Company's subsidiaries are generally subject to an income tax at an effective rate of 25% on income reported in the statutory financial statements after appropriate tax adjustments, unless the enterprise is located in a specially designated region where it allows enterprises a three-year income tax exemption and a 50% income tax reduction for the following three years or the enterprise is a manufacturing related joint venture with a foreign enterprise or a wholly owned subsidiary of a foreign enterprise, where it allows enterprises a two-year income tax exemption and a 50% income tax reduction for the following three years.

Under the Income Tax Laws of Beijing State Administration Taxation of PRC, any enterprise with manufacturing operations in the City of Beijing who is a wholly owned subsidiary of a foreign enterprise is subject to income tax rate of 24%.

The Company's subsidiaries were paying the following tax rate for the year ended December 31, 2006.

Subsidiaries	Income tax exemption	Effective income tax rate
Sureland Industrial	9%	24%
Sureland Equipment	33%	0%
Beijing Hua An	33%	0%
Beijing Zhong Xiao Fire Safety Technology Co., Ltd.	18%	15%

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The Company's subsidiaries were paying the following tax rate for the year ended December 31, 2007.

Subsidiaries	Income tax exemption	Effective income tax rate
Sureland Industrial	33%	0%
Sureland Equipment	33%	0%
Beijing Hua An	33%	0%
Tianxiao Equipment	0%	33%

Beginning from January 1, 2008, the new Enterprise Income Tax ("EIT") law replaced the existing income tax laws for Domestic Enterprises ("DES") and Foreign Invested Enterprises ("FIEs").

The key changes are:

a. The new standard EIT rate of 25% will replace the 33% rate currently applicable to both DES and FIEs, except for High Tech companies who pays a reduced rate of 15%;
b. Companies established before March 16, 2007 will continue to enjoy tax holiday treatment approved by local government for a grace period of the next 5 years or until the tax holiday term is completed, whichever is sooner.

The Company's subsidiaries are paying the following tax rate for the year ended December 31, 2008.

Subsidiaries	Income tax exemption	Effective income tax rate
Sureland Industrial	25%	0%
Sureland Equipment	12.5%	12.5%
Beijing Hua An	25%	0%
Tianxiao Equipment	0%	25%

The provision for income taxes amounted to $47,423, $5,081, and $82,206 for the years ended December 31, 2008, 2007 and 2006, respectively.

The following table reconciles the U.S. statutory rates to the Company's effective tax rate for the years ended December 31:

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	2008	2007	2006
U.S. Statutory rates	34.0%	34.0%	34.0%
Foreign income not recognized in USA	(34.0)	(34.0)	(34.0)
China income taxes	25.0	33.0	33.0
China income tax exemption	(24.8)	(33.0)	(32.0)
Total provision for income taxes	0.2%	0.0%	1.0%

The estimated tax savings for the years ended December 31, 2008, 2007 and 2006 amounted to $6,382,286, $5,441,008 and $3,206,276, respectively. If the income tax had been applied, the net effect on both basic and diluted earnings per share for the years ended December 31, 2008, 2007 and 2006 by $0.23, $0.20 and $0.13, respectively.

China Fire & Security Group, Inc. was incorporated in the United States and has incurred net operating losses of $0, $47,946 and $3,478 for income tax purposes for the years ended December 31, 2008, 2007 and 2006, respectively. The net operating loss carry forwards for United States income taxes amounted to $1,004,414 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilize, from 2025 through 2027. Management believes that the realization of the benefits from these losses appears uncertain due to the Company's limited operating history and continuing losses for United States income tax purposes. Accordingly, the Company has provided a 100% valuation allowance on the deferred tax asset benefit to reduce the asset to zero. The net change in the valuation allowance for the year ended December 31, 2008 was $0 and the accumulated valuation allowance as of December 31, 2008 amounted to $341,501. Management reviews this valuation allowance periodically and makes adjustments as warranted.

Taxes payable

Taxes payable consisted of the following:

	December 31, 2008	December 31, 2007
VAT taxes payable	$ 1,094,089	$ 71,367
Income taxes payable	38,406	5,915
Sales taxes	936,164	979,999
Other taxes payable	24,086	31,054
Total	$ 2,092,745	$ 1,088,335

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Note 11 - Retirement plan

The Company and its subsidiaries are required to participate in a central pension scheme operated by the local municipal government. The Company is required to contribute 20% of its payroll costs to the central pension scheme in 2008 and 2007. The contributions are charged to the income statement of the Company as they become payable in accordance with the rules of the scheme. The aggregate contributions of the Company to retirement benefit schemes amounted to $250,720, $158,279, and $37,444 for the years ended December 31, 2008, 2007 and 2006, respectively.

Note 12 - Statutory reserves

The laws and regulations of the People's Republic of China require that before an enterprise distributes profits to its partners, it must first satisfy all tax liabilities, provide for losses in previous years, and make allocations, in proportions determined at the discretion of the board of directors, after the statutory reserve. The statutory reserves include surplus reserve fund and the enterprise fund. These statutory reserves represent restricted retained earnings.

Surplus reserve fund

The Company is required to transfer 10% of its net income, as determined in accordance with the PRC accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the Company's registered capital.

The transfer to this reserve must be made before distribution of any dividend to shareholders. For the years ended December 31, 2008, 2007 and 2006, the Company transferred $2,081,766, $1,641,434 and $572,302, respectively. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

On May 17, 2007, the Beijing Shunyi District Business Administration approved the Company to increase registered capital from $6,515,000 (RMB 50,000,000) to $13,030,000 (RMB 100,000,000). $605,000 (RMB 5,000,000) was approved by the Beijing Shunyi District Business Administration to be transferred out from this surplus reserve fund as an increase of registered capital. This balance was reflected in the Company's consolidated shareholders' equity for the year ended December 31, 2007.

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Enterprise fund

The enterprise fund may be used to acquire plant and equipment or to increase the working capital to expend on production and operation of the business. No minimum contribution is required and the Company did not make any contribution to this fund for the years ended December 31, 2008, 2007 and 2006.

Note 13 - Shareholders' equity

On January 30, 2008, the Company's 2008 Omnibus Long-term Incentive Plan was adopted and approved by shareholders. Pursuant to the 2008 Omnibus Long-term Incentive Plan, the Company reserved 2,000,000 shares of our common stock for issuance.

On March 12, 2008, the Company's Board of Directors authorized the repurchase of up to $10 million of the Company's outstanding common stock.

Warrants

On April 26, 2007, the Company amended its Series A and Series B warrants issued to certain investors on October 27 and December 5, 2006 pursuant to the Securities Purchase Agreement in connection with a private placement (the "Amendment"). The Amendment eliminates the right of the warrant holders to be paid in cash in the event of a merger or other types of reorganization. The warrants no longer need to be accounted for as derivative instrument liabilities. The fair value of the warrants were transferred to equity on the signing date and no further accounting (i.e., no mark-to-market) is required going forward. At April 26, 2007, the Company determined the fair value of the warrants was $1,475,020 using the Cox-Ross-Rubinstein binomial model with the following assumptions: volatility 25%; risk free interest rate 4.59%; dividend yield of 0% and expected term of 4.5 years. On April 26, 2007, the fair value of the warrants was transferred to additional paid-in capital.

In 2007, 492,340 series A warrants were exercised at $3.58 and 492,340 series B warrants were exercised at $4.88 for a total of 984,680 shares of common stock. The Company received a total of $4,165,197 from various warrant holders.

In 2007, a total of 179,626 warrants were converted into 110,535 shares of common stock by the warrants holders using the cashless exercise options. In 2008, a total of 5,000 warrants were converted into 3,634 shares of common stock by the warrants holders using the cashless exercise options.

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On February 1, 2007, CFPG issued 50,000 warrants to Hayden Communication, the Company's investor relations consultant, as part of its compensation. These warrants meet the conditions for equity classification pursuant to SFAS 133 and EITF 00-19. Therefore, the warrants were classified as equity and accounted as compensation expenses. The warrants vested on February 1, 2008. The Company used the Black Scholes model to value the options at the time they were issued, based on the exercise price of $4.25 and expiration dates of the instruments, a risk-free rate of 4.84% and volatility at 50%. These 50,000 warrants had a fair value of $94,274 on the date of grant and were recognized over the one year service period. In 2008, Hayden Communication converted 40,000 warrants into 26,066 shares of common stock in a cashless exercise.

The Company's warrant activity is as follows:

	Warrants Outstanding	Warrants Exercisable	Weighted Average Exercise Price	Average Remaining Contractual Life
Outstanding, December 31, 2005				
Granted	1,169,306	1,169,306	$ 4.23	5.00
Forfeited				
Exercised				
Outstanding, December 31, 2006	1,169,306	1,169,306	$ 4.23	4.58
Granted	50,000		$ 4.25	
Forfeited				
Exercised	(1,164,306)	(1,164,306)	$ 4.23	
Outstanding, December 31, 2007	55,000	5,000	$ 4.19	4.08
Granted		50,000	$ 4.25	
Forfeited				
Exercised	(45,000)	(45,000)	$ 4.24	
Outstanding, December 31, 2008	10,000	10,000	$ 4.25	2.09

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Note 14 - Options issued to employees

On July 1, 2006, CFPG issued 750,000 options to the employees of Sureland Industrial. Fifty percent of the options vest immediately, with the balance vesting evenly each quarter over the following two years. The Company used the Cox-Ross-Rubinstein binomial model to value the options at the time they were issued, based on the stated exercise prices and expiration dates of the instruments and using a risk-free rate of 5.11%. Because the Company does not have a history of employee stock options, the estimated life is based on one half of the sum of the vesting period and the contractual life of the option. This is the same as assuming that the options are exercised at the mid-point between the vesting date and expiration date.

The Company's stock was not traded when the options were granted. Therefore, the Company had to estimate the market value of its shares. There was no significant change in the business between July and October 2006, therefore, the company used the fair value from the October 27 transaction of $2.26 and took a discount of 30%, to estimate a market price of $1.58. At that market price, the 750,000 employee options had a fair value of approximately $834,000. Because 50% of the options vested immediately, the related compensation expense was recognized as the options vest, rather than on a straight-line basis over the total vesting period, as the amount recognized at any point in time must be at least equal to the portion vested.

On April 20, 2007, CFPG issued 9,500 options to the Company's four independent directors as part of their compensation. The options will vest one year from the issuance date. The fair value of these options was determined to be $19,428 using the Black Sholes model with the following assumptions: volatility 45%; risk free interest rate 4.57%; dividend yield of 0% and expected term of 5 years. Options were vested immediately at exercise price of $4.51 per share which was the close price of the Company's stock on April 19, 2007. Because the services that the independent directors are to provide started from the second quarter of 2007 and will last for one year, the related compensation expense is recognized on a straight-line basis over the total service period.

On July 1, 2007, CFPG issued 20,000 options to Mr. Yuan, Xiaoyuan, who joined the Company as on the same day. The options will vest over four years. The Company used the Black Sholes model to value the options at the time they were issued, based on the exercise price of $6.70, which was the close price of the Company's stock on June 30, 2007 and expiration dates of the instruments and using a risk-free rate of 4.84% and the volatility of 40% that was estimated by analyzing the trading history of the Company's stock. The 20,000 employee options had a fair value of $57,178. The related compensation expense is recognized on a straight-line basis over the four year vesting period.

The total stock option compensation expense recognized for the year ended December 31, 2008, 2007 and 2006 was $40,152, $190,719 and $644,000, respectively.

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The Company has stock options as follows:

	Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, December 31, 2005			
Granted	750,000	$ 1.25	$ 247,500
Forfeited			
Exercised			
Outstanding, December 31, 2006	750,000	$ 1.25	$ 2,250,000
Granted	29,500	$ 5.99	
Forfeited			
Exercised			
Outstanding, December 31, 2007	779,500	$ 1.43	$ 8,925,615
Granted			
Forfeited			
Exercised			
Outstanding, December 31, 2008	779,500	$ 1.43	$ 4,194,190

Following is a summary of the status of options outstanding at December 31, 2008:

Outstanding Options			Exercisable Options		
Number of Options	Exercise Price	Average Remaining Contractual Life	Number of Options	Exercise Price	Average Remaining Contractual Life
750,000	1.25	7.50	750,000	1.25	7.50
9,500	4.51	3.33	9,500	4.51	3.33
20,000	6.70	3.50	7,500	6.70	3.50

Note 15 - Restructuring of subsidiaries

On April 2, 2007, the Company evaluated the operations of its subsidiary, Beijing Zhong Xiao Fire Safety Technology Co., Ltd. (“Beijing Zhong Xiao”) and noted efficiencies could be obtained by consolidating the operations of Beijing Zhong Xiao into Sureland Equipment.

Beijing Zhong Xiao was a subsidiary of Sureland Industrial established in the PRC as a limited liability company on March 18, 2003. On April 3, 2007, Sureland Industrial signed an agreement to transfer 100% ownership in Beijing Zhong Xiao to Gong Gang Qiang, a Chinese individual, for consideration price equal to the net assets of Beijing Zhong Xiao as of March 31, 2007.

No gain or loss was recognized through the restructuring of Beijing Zhong Xiao nor any additional cost incurred to restructure Beijing Zhong Xiao. In addition, we have no outstanding obligations related to the restructuring after the disposal of Beijing Zhong Xiao on April 3, 2007.

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After the restructuring of Beijing Zhong Xiao, the Company still has a significant continuing involvement in the historical operations of the manufacturing of fire safety and protection products through Sureland Equipment, which results in the Company failing the test in paragraph 42 of FAS 144 “Accounting for the Impairment or Disposal of Long-Lived Assets”. The failure of this test therefore does not require the classification of the disposal of Beijing Zhong Xiao as a discontinued operation.

Note 16 - Commitments and Contingencies

Operating Lease Commitments

Currently the Company are engaged in an operating lease with Tianjin Fire Protection Equipment Company Ltd for the use of approximately 112,432 square meters land in Tianjin, consisting of manufacturing facilities, warehouses and office buildings. The term of the operating lease is two years, starting from May 2007. The monthly payment for the lease is 66,000RMB or $9,677. At December 31, 2008, total future minimum lease payments under the operating lease were as follows:

Year Ended December 31	Amount
2009	$ 48,385
2010	-
Thereafter	-

Contingencies

In 2008, the Company filed five lawsuits against four different companies for the infringement of the Company’s intellectual properties. These five cases were still pending. Management expects these five cases will be settled in the Company’s favor.

In 2008, the Company was sued by three different companies for the invalidation of our intellectual properties. Two of these three cases were eventually settled in the Company’s favor. The other case is still pending and management expects this case will be settled in the Company’s favor as well.

Management expects the outcome from the above pending lawsuits will have no material impact of the Company’s consolidated financial statements.

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Note 17 - Subsequent Events

On January 2, 2009, pursuant to the Company's 2008 Omnibus Long-term Incentive Plan, the Company's Board of Directors authorized the issuance of 1,000,000 shares of options for its employee with total 800,000 shares options issued to executive officers. The options will vest evenly each quarter over the following four years, starting from the first quarter of 2009.

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EXHIBIT INDEX

Exhibit Number	
2.1*	Securities Exchange Agreement, dated as of September 1, 2006, by and among the Company, China Fire Protection Group and Sureland, its subsidiary
3.1**	Restated Articles of Incorporation, filed with the state of Florida on October 18, 2006.
3.2**	Articles of Amendment to Articles of Incorporation & Designating Series A Convertible present Stock.
3.3	By-Laws - Incorporated by reference to Exhibit 3.1 to Form 8-K filed on September 4, 2008.
4.1**	Registaration Rights Agreement dated October 27, 2006 between the Company and named Investors
4.2**	Registaration Rights Agreement dated October 27, 2006 between the Company and named Shareholders
4.3**	Form of Series A Warrant to Purchase Shares of Common Stock of the Company.
4.4**	Form of Series B Warrant to Purchase Shares of Common Stock of the Company
4.5**	Escrow Agreement dated October 27, 2006 by and among the Company UNIPRO, H. C. Wainwright & Co., Inc., the Investor Representative, Gangjin Li, and Brian Li, and American Stock Transfer & Trust Company
4.6**	Form of H. C. Wainwright & Co., Warrant
10.1**	Construction Contract between Anshan Iron & Steel Group Corp. and Sureland Industrial Fire Safety Co., Ltd. Dated October, 2006
10.2**	Contract between Maanshan Iron & Steel Co., Ltd and. and Sureland Industrial Fire Safety Co., Ltd.
10.3**	Contract between Wuhan Iron & Steel (Group) Corp. and Sureland Industrial Fire Safety Co., Ltd.
10.4**	Purchase Contract between Beijing Zhongshiweiye Technologies Co. Ltd.. and Sureland Industrial Fire Safety Co., Ltd. Dated June 13, 2005
10.5**	

	Contract between Hangzhou New Epoch Fire Protection Science & Technology Co., Ltd and Sureland Industrial Fire Safety Co., Ltd. Dated December 5, 2005
10.6**	Contract between Guangzhou Jinshengyang Technologies Co. Ltd. and Sureland Industrial Fire Safety Co., Ltd. Dated May 20, 2005
10.7**	Purchase and Sales Contract between Beijing Xinfangsheng Hardware Electric Products Co. Ltd. and Sureland Industrial Fire Safety Co., Ltd. Dated October, 2005
10.8**	Purchase and Sales Contract between Sichuan Firefighting Machinery General Factory and Sureland Industrial Fire Safety Co., Ltd. Dated July 19, 2005
10.9**	Purchase and Sales Contract between Beijing Tianningyihe Pipeline System Equipments Co. Ltd. and Sureland Industrial Fire Safety Co., Ltd. Dated July 19, 2005

Exhibit Number	
10.10**	Acceptance for Carriage Service Contract between Zhaijisong Express Co., LTD and Sureland Industrial Fire Safety Co., Ltd.
10.11**	Cooperation Contract between Lianxin International Trade (Shanghai Waigaoqiao Free Trade Zone) Co., Ltd. and Sureland Industrial Fire Safety Co., Ltd.
10.12**	Marketing Memorandum between Xi'an Systemsensor Electronic Co., Ltd and Sureland Industrial Fire Safety Co., Ltd.
10.13**	OEM Cooperation Agreement between Xi'an System Sensor Electronics, Ltd. and Sureland Industrial Fire Safety Co., Ltd. Dated may 26, 2004
10.14**	House Lease Contract between Beijing Bestpower Electrical Technology Ltd. and Sureland Industrial Fire Safety Co., Ltd. Dated December 1, 2004
10.15**	Stock Ownership Assignment Agreement
10.16	Employment Agreement between the Company and Mr. Brian Lin
10.17	Employment Agreement between the Company and Mr. Xiaoyuan Yuan
14.1***	Officers' and Directors' Code of Ethics
21.1	List of Subsidiaries
31.1	Certification of Principal Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350

* Incorporated by reference from 8-K filed September 5, 2006 where it was filed as Exhibit 99.1

** Incorporation by reference from 8-K filed November 2, 2006 where the exhibits were the same number

*** Incorporated by reference from Form 10-QSB, filed with the Commission on May 24,2004 where it was filed as Exhibit 10.4