

CHINA FIRE & SECURITY GROUP, INC.  
Form 10-K  
March 16, 2011

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010

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  
(I.R.S. Employer Identification No.)

B-2502 TYG Center, C2 Dongsanhuanbeilu,  
Chaoyang District, Beijing 100027,  
People's Republic of China  
(Address of principal executive offices)

(86-10) 8441 7400  
(Issuer's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Common Stock, \$.001 Par Value  
(Title of Class)

The Nasdaq Capital Market, LLC  
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Exchange Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [ ] No [ x ]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [ x ] No [ ]

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting  
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act):  
Yes  No

The aggregate market value of the 10,436,441 shares of voting and non-voting common equity stock held by non-affiliates of the registrant was \$95,806,528 as of June 30, 2010, the last business day of the registrant's most recently completed second fiscal quarter, based on the last sale price of the registrant's Common Stock on such date of \$9.18 per share, as reported by The NASDAQ Stock Market, Inc.

As of March 15, 2011, there were 27,855,934 shares of Common Stock of China Fire & Security Group, Inc. outstanding.

Except as otherwise indicated by the context, references in this Form 10-K to:

"China Fire & Security Group," the "Company," "CFSG," "we," "us" or "our" are references to the combined business of China Fire & Security Group, Inc. and its direct and indirect subsidiaries.

"U.S. Dollar," "\$" and "US\$" means the legal currency of the United States of America.

"RMB" means Renminbi, the legal currency of China.

"China" or the "PRC" are references to the People's Republic of China.

"U.S." is a reference to the United States of America

"SEC" is a reference to the Securities & Exchange Commission of the United States of America.

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## PART I

### Item 1. Business

#### Overview

We are engaged primarily in the design, development, manufacture and sale of a variety of fire safety products for the industrial and special purpose infrastructure industries and the design and installation of industrial fire safety systems in which we primarily use our own fire safety products. To a minor extent, we provide maintenance services on our industrial fire safety systems for our customers. Our business is primarily in China, where we operate sales and liaison offices in more than 20 cities; we are also expanding our business overseas by providing integrated fire safety systems to industrial clients globally.

We market our industrial fire safety products and systems primarily to major companies in the iron and steel, traditional power generation, nuclear power generation and petrochemical industries in China. In the last two years, we also secured several contracts with power generation plants in India. We are further developing our business in the transportation sector, which includes projects involving subways, highway tunnels, high speed trains and marine transportation, and telecommunications.

We have internal research and development facilities engaged primarily in furthering fire safety technologies. We believe that our technologies allow us to offer cost-effective and high-quality fire safety products and systems. We have developed products for industrial fire detecting and extinguishing. We believe that we are the leading manufacturer in China of such systems having successfully developed a comprehensive line of linear heat detectors.

Our company is the result of a share exchange completed on October 27, 2006 between Unipro Financial Services, Inc., a Florida corporation (“Unipro”) and the shareholders of China Fire Protection Group, Inc., a limited liability company organized under the laws of the British Virgin Islands (“CFPG”). The share exchange resulted in a change of control of Unipro, with the former shareholders of CFPG owning approximately 80.5% of the company on a fully diluted basis after the share exchange. The directors and officers of CFPG became our directors and officers in conjunction with the share exchange. Effective as of January 31, 2007 we changed our name to China Fire & Security Group, Inc.

We have twice been ranked as the leading Chinese industrial fire safety company by the China Association for Fire Prevention based on six major factors including total revenue, growth rate, net profit, return on assets, investment in research and development and intellectual property. During the last three years, we were also continuously ranked as the leading fire protection brand in China in a survey conducted by [www.HC360.com](http://www.HC360.com). HC360 is a leading B2B electronic commerce services provider in China and runs the largest commercial website in China's fire protection industry ([www.fire.HC360.com](http://www.fire.HC360.com)). Our key products include linear heat detectors and water mist extinguishers.

#### Our Strategies:

We aim to further leverage our total solution business model, proprietary core technology and products, and strong management team to seek innovations in total solution sales, systems and technologies, and project management and to achieve accelerated growth while significantly lowering costs. We intend to achieve our goals through the following key strategies:

We plan to continue to develop and capture opportunities in providing fire protection total solutions to high end customers in industrial and special purpose infrastructure industries.

In the iron and steel industry, we will utilize our breakthroughs in the retrofitting and maintenance services area to win more contract opportunities in 2011 and 2012 and to capitalize on the industry's continued consolidation.

- o We plan to promptly and selectively expand into new verticals and international markets. New targeted verticals include: conventional power plants, power transmission (grid), nuclear power plants, petroleum and natural gas, petrochemical, transportation (subways, highway tunnels, high speed trains), ships and marine transportation, telecommunications carriers.

We plan to further enhance proprietary product research and development, standardization, industrialization and intellectual property protection, in order to broaden our product portfolio, improve profitability, help penetrate new

verticals, and increase product sales through direct and independent third-party channels.

- o We plan to further enhance fire codes in the iron and steel industry and other new verticals and initiate improvements on certain current product standards at the national and international levels.
- o In addition to core products in industrial fire detection and suppression systems, we plan to expand our product portfolio through internal development and partnership with third parties, and to provide our customers with integrated product development and scaled product manufacturing.
- o We aim to increase the market share of our integrated products by offering total solutions to our customers as well as by product sales through independent channels.

We plan to build a stronger management platform to support accelerated business growth by improving corporate management capabilities in contract budgeting, financial control and auditing, and human resources management.

We will be strategic in joint venture and mergers and acquisition opportunities. Our objective in potential selective and strategic joint ventures and mergers and acquisitions is to augment our organic growth strategy.

## Our Industry

### The Industrial Fire Safety Industry

The fire safety industry can be generally divided into three major segments: residential, commercial and industrial. The industrial fire safety business requires greater technical expertise than the residential or commercial fire safety businesses due to the hazardous conditions of the industrial environment. Designers must consider a myriad of complex technologies, safety factors and unique fire hazard risks associated with various areas of production. Designers must also contend with adverse environmental problems such as humidity and dust and electro-magnetic interference to develop solutions to analyze and mitigate the spread of fire and chain reactions that are more likely to occur in the automated industrial production environment.

Along with China's modernization drive, its economy has witnessed significant growth in the past three decades, which brought about rapid growth in various industrial sectors, including the iron and steel as well as the power and petrochemical industries. Moreover, due to its investment environment and relatively low cost labor, China has attracted many manufacturers from developed countries. China's increasing industrial capacity has caused, and is anticipated to continue to cause, a high level of demand for industrial fire safety products and services.

Due to the increased loss of lives and properties as a result of fires, the Chinese government began to attach increasing importance to industrial fire safety in the 1990's. The government enacted various laws and issued regulations on fire safety, of which the most important included the Fire Safety Law of 1998 and the Safe Production Law of 2002. On May 1, 2009, the government released the amendment to the Fire Safety Law in which it stressed that the principal of an enterprise or a building is personally liable for fire casualties. These laws, while expressing the government's increased emphasis on fire safety, can be vague and are not in and of themselves responsible for the increase in demand. More important to the demand for products and services are fire codes for various industrial sectors. In April 2007, China's Ministry of Construction published a fire code entitled "Code of Design on Fire Protection and Prevention for Iron and Steel Metallurgy Enterprises", which became effective on January 1, 2008. This fire code is applicable to all new build-out of plants, and the expansion and renovation of the existing facilities of any iron and

steel company.

The fire safety industry has historically used foreign products, which have been superior in technology and quality. In recent years, Chinese products have improved in terms of technology and quality and are being increasingly accepted. The competitive price of Chinese products has also become a competitive advantage.

The industry for the design, manufacture and installation of fire safety systems is fragmented with no dominant players. As a result, we believe that there is an opportunity for consolidation and expansion which will allow major players to emerge.

#### Our Leadership Position in the Industry

We began in 1995 as the first Chinese company specializing in industrial fire safety. We believe that we have established ourselves as the recognized leader in the industrial fire safety business in China based on the following competitive advantages:

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A large number of mid-to-high end loyal customers in various industries:

China Fire has been issued the top level certificates for both System Contracting and Engineering from the Ministry of Construction of China. China Fire was ranked No. 1 in the survey of System Contracting Enterprises undertaken by China Fire Association in 2001. Leveraging its own products with proprietary technologies and comprehensive design experience, China Fire has superior capabilities and expertise in providing total fire protection systems to industrial customers. China Fire serves a long list of mid-to-high end loyal customers in various industries including iron and steel, petrochemical, traditional power, nuclear power, and transportation. We receive repeat business from these customers when they build new projects or rebuild their existing plants.

Technological leadership; several high valued proprietary intellectual properties:

China Fire has developed a series of proprietary technologies for industrial fire safety products including linear heat detectors which have been awarded dozens of patents worldwide. These technologies have enabled the Company to become one of the chief editors for relevant national fire product standards. Leading technologies, proprietary patent protection and our influence over fire safety standard have contributed to China Fire's unique market leading position with sustainable advantages.

Lead and influence the enhancement of various national fire codes and product standards:

China Fire is an editorial member of the national Codes of Fire Protection Standards for Metallurgy, Iron & Steel Enterprises, and of the "Linear Heat Detector" and participates in various other fire codes at the national and provincial level. These enhancements have improved fire safety standards in China and created larger market demand for many products including our proprietary products which have better prices and reliability.

Specialized research and development centers and manufacturing bases for fire detection products and fire suppression products:

China Fire has a specialized research and development center and manufacturing base for fire detection products in Beijing and another research and development center and manufacturing base for fire suppression products in Tianjin. Recognized by the government as a high-tech enterprise, China Fire has ample manufacturing capacity to support its future business growth in specialized fire detection and suppression products.

Experienced management team with established track record for sustained growth:

China Fire has a strong management team which consists of experts in technology, sales and marketing and general management. The core team has both domestic experience and international vision with a strong track record in the fire protection industry.

#### Our Products and Services

Our major customers are in the iron and steel (contributing approximately 77.7% of revenues), traditional power generation (contributing approximately 6.9% of revenues) and petrochemical (contributing approximately 5.8% of revenues) industries. Our revenues are mainly from three sources: Total Solutions, Product Sales, and Maintenance Services. In 2010, revenues from total solutions accounted for approximately 74.5% of total revenues and the sale of products integrated accounted for approximately 21.0% of total revenues, while maintenance services accounted for approximately 4.5% of total revenues.

#### Total Solutions

We design and install total fire protection systems for our clients. A fire protection system consists of three major components: fire detectors, fire alarm control and network supervisory systems, and fire extinguishing systems. In most cases, we design and install all three components. The price of systems varies with the size and complexity of the installation, ranging from \$10,000 to \$92 million. In 2010, we designed and installed more than 220 systems. The design and installation of a system can take one month to three years, depending on the complexity of the system. Approximately 11% of the systems take less than one year to complete, while approximately 89% of the systems require more than one year. Revenues from total solutions typically can be broken down as follows: 50-65% of revenues from products manufactured by us; 25-40% of revenues from products manufactured by third parties; and 10% of revenues from services (the design and installation). The price of our own products incorporated into the total solution

systems we design and install is similar to that sold directly to our customers. The markup for third party products is approximately 20-30%.

We maintain long-term relationships with the majority of our customers. In 2010, the top-five projects for total solution systems that we implemented for our customers (based on its revenue recognized and the percentage contribution) were as follows:

#### Top-Five Customers of Our Total Solutions in 2010

| Name  | Industry   | Amount of Revenues<br>(in thousands)<br>(\$) | Percentage of<br>Total Solution<br>Revenues |
|---|------------|--|---|
| Wuhan Iron & Steel Group                        | Metallurgy | 32,951                                       | 55.3%                                       |
| Capital Iron & Steel Group (Caofeidian Project) | Metallurgy | 5,067  | 8.5%  |
| Anshan Iron & Steel Group Chaoyang Company      | Metallurgy | 2,116  | 3.5%  |
| Handan Iron & Steel Baogang                     | Metallurgy | 2,035  | 3.4%  |
| Anshan Iron & Steel Group Bayuquan Company      | Metallurgy | 1,777  | 3.0%  |
| Total   |            | 43,946                                       | 73.8%                                       |

#### Products

Depending on the requirements of our clients, we provide integrated fire protection products. By selling products we manufacture and incorporating products outsourced from third parties we provide a complete system for our clients. Such revenues do not include the sale of our products in connection with our total solution business or the design and installation of fire protection systems. We manufacture the following products, which can be divided into three categories according to their functions:

Fire Detectors. The products include:

- Linear Heat Fire Detectors
- Multi-Frequency Infrared Flame Detectors
- Infrared and Ultraviolet Composite Flame Detector
- Long Range Infrared Combustible Gas Detectors
- Fixed Point Combustible Gas Detectors
- Point Fire Detectors

Fire Alarm Control and Network Supervisory Systems. The products include:

- Fire Alarm Control Unit
- Electric Fire Monitoring System
- Fire Control Room Display System
- Fire Safety Monitoring Center System
- Remote Customer Service System

Fire Extinguishing Systems. The products include:

- Water Mist Fire-Extinguishing System
- Anti-False-Spray Water Spray Fire-Extinguishing System
- Gas-Based Fire-Extinguishing System
- Foam-Based Fire-Extinguishing System
- Portable and Transportable Fire Extinguishers
- High-Pressure Cylinders

We focus on the production and sales of our proprietary products, which are associated with our technologies and intellectual properties. The sales of our proprietary products, which include our liner heat detectors and water mist fire-extinguishing systems, contribute a higher gross margin than the products outsourced from the third parties.

In 2010, we developed new products, including infrared and ultraviolet composite flame detectors, electric fire monitoring system and high-pressure water mist fire-extinguishing system. We believe that the development of these new products will enhance our product offerings and strengthen our competitive position.

We have established quality assurance systems throughout the company and achieved ISO9001:2000 certification since 2001. ISO9001:2000 refers to a quality management system which demonstrates the company's ability to consistently provide products that meet applicable regulatory requirements and aim to enhance customer satisfaction. We believe these certifications are recognition of our commitment to and efforts in implementing and maintaining a quality management system in the design, manufacturing and sales of our fire safety products.

The tables below list our top-five Products Sales customers as of December 31, 2010. The amounts and percentages do not include the sales of our products as part of total solutions:

#### Top-Five Customers of Our Product Sales in 2010

| Name   | Industry      | Sales in<br>(in thousands)<br>(\$) | Percentage of<br>Total Product<br>Sales |
|--|---------------|------------------------------------|---|
| Shenhua Group Baotou Coal Chemical Corporation       | petrochemical | 2,504                              | 14.8%                                   |
| China Nuclear Power Engineering Co., Ltd.            | Nuclear       | 1,417                              | 8.4%                                    |
| Dongfang Electric Corporation                        | Power         | 989                                | 5.9%                                    |
| Wuxi Tianyou Special Detector Technology Corporation | Others        | 736                                | 4.4%                                    |
| Anshan Iron & Steel Group                            | Metallurgy    | 566                                | 3.4%                                    |
| Total  |               | 6,212                              | 36.8%                                   |

#### Our Intellectual Property

We develop our own technologies for our products and services. We own 88 patents and have 16 pending applications in China and internationally. These patents are related to fire detecting, system control, and fire extinguishing technologies as listed in the table below.

#### Our Intellectual Properties

| Product                                | Patents<br>Issued | Patents<br>Pending |
|--|-------------------|--------------------|
| Linear Heat Fire Detectors             | 70                | 14                 |
| Infrared Flame Detectors               | 1                 | 0                  |
| Water Mist Nozzles                     | 8                 | 0                  |
| Remote System Control Device           | 0                 | 0                  |
| Fire Alarm Control Device              | 0                 | 0                  |
| Foamed-Based Fire Extinguishing Device | 2                 | 1                  |
| Others                                 | 7                 | 1                  |
| Total                                  | 88                | 16                 |

We own seven copyrights for software used for detecting assembly and control modules. We have developed proprietary software to provide localized and network-based fire detection and monitoring solutions. We believe that we are the first company in China to provide customers with remote system monitoring services based on our network-based solutions. From our centralized monitoring center, we can detect any status change (major alarm, critical alarm, fire alarm, etc.) in the major components of each system, upload information, and take appropriate

actions if needed. We have been granted copyrights for such software by China's State Bureau of Copyrights.

We have thirteen registered trademarks for our products and services approved by the State Administration for Industry and Commerce of China,. In addition, we currently own three internet domain names "www.sureland.com.cn", "www.sureland.com." and "www.chinafiresecurity.com".

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### Our Research and Development Efforts

We currently have approximately 21 members on our research and development (“R&D”) team. Most of our R&D staff have been working in the field of fire safety products for over five years. Research and development costs were \$1,966,557 and \$1,631,435 during the years ended December 31, 2010 and 2009, respectively.

Our research and development activities involve improving upon existing products, developing new products, designing better and more efficient fire safety systems, and developing new applications for such products and systems. We are currently developing new technologies for anti-explosive gas bottles, alternate foam storage and mix device and high-pressure water mist systems. We plan to conduct R&D to develop infrared flame detectors and industrial fire protection monitoring and control systems in the future. Our R&D activities also involve further developing and improving our core manufacturing technologies so that we can expand our product lines and reduce overall costs. We have entered into joint research and development agreements with some universities whereby we have exclusive ownership to any technology developed. These efforts have led to the successful development of numerous peripheral products for our fire safety systems. For example, we have enhanced our network based fire protection system monitoring software through a joint development program between the Company and Wuhan Iron and Steel University. In 2008, we established a Fire Safety Research Center with Wuhan Technology University.

To enhance our R&D capabilities, we completed the construction of a new R&D center in 2006, consisting of a 1,800 square meter building with new R&D equipment. The total spending for the construction and equipment was approximately \$1 million. The center is devoted to our research and development efforts and to the development of integrated manufacturing practice and processes. The center is a base for training research and technical personnel and for developing additional proprietary technologies.

### Our Marketing Efforts

Currently, we have established our position as the leading Chinese supplier of fire safety products and services in the iron and steel, power and petrochemical industries. We have installed 80% of the large systems in the iron and steel industry. Our business plan is to maintain our leadership and expand our market share in the iron and steel, power and petrochemical markets, while targeting several new market segments which we believe offer expansion opportunities, including transportation (highways, subways and railways) and nuclear power generation. We also have installed fire safety systems for the warehouses of distilleries and cigarette factories.

Our marketing efforts have made us one of the leading suppliers of fire safety products and services in China. All of our products and services are marketed and sold through our direct sales force. Under Chinese laws and regulations, a company which plans to install fire safety systems must apply to the relevant government agency for the approval of the project. Due to our relationship with these agencies, we are able to receive information about projects under consideration in advance and prepare for the bidding accordingly. Our sales force regularly visits the research and design institutes under those agencies to educate them with our products and to share with them our experiences in the design and deployment of fire protection systems for industrial facilities. These marketing efforts better position us for receiving contracts for fire safety systems when they design a new plant or facility. Almost all of our contracts are procured through an open bidding or invitation only bidding process. Contracts secured without bidding usually provides us with higher margins.

Our linear heat detectors and water/mist extinguishers have received the UL certification. We have an OEM arrangement with Xi’an System Sensor Electronics Co., Ltd., a China subsidiary of Honeywell, for OEM manufacturing of linear heat detectors for Honeywell. We have signed an additional three OEM manufacturing agreements with another two multinational companies under confidential terms.

We are actively expanding our marketing network into other parts of China. We have established sales offices and liaison offices in more than 26 locations. Mainly through internal growth, we project an increase in the number of sales and liaison offices. In April 2009, we entered into an agreement with Jinan Iron & Steel, China's eighth-largest steel producer and a leading exporter of medium and thick steel plates, to serve as the turn-key fire protection solution provider and to implement Jinan Iron & Steel's automated fire protection system.

Our sales team has approximately 60 members. To expand distribution channels and increase our market share, we regularly attend industrial exhibitions organized by local and national industrial associations. We run advertisements in major industry journals, magazines and catalogues. We also run advertisements on industry websites including [www.china-fire.com](http://www.china-fire.com) and [www.fire.hc360.com](http://www.fire.hc360.com).



## Material and Parts Supply

We manufacture products that provide higher margins and subcontract products with comparatively lower margins. Given the importance to our business of key materials and parts, the purchasing and management of these important functions are top priorities. We carefully manage our purchasing efforts and have established company policies involving materials and parts procurement. The cost of materials for our own products is approximately 80-90% of the total production cost.

## Supplier Management System

We have adopted measures to reduce risks in materials and parts supply, including 1) obtaining better services and higher quality, 2) diversifying suppliers and supply sources, and 3) seeking long-term contracts with suppliers.

## Purchasing Procedures

Our production department collaborates with our quality and procurement department to produce a list of qualified suppliers that is based on quality, price, technical competency and capacity. Purchasing transactions are sometimes conducted in accordance with procedure for bidding invitations. Potential suppliers are evaluated on their proposed terms, technical specifications, price, payment terms and timing for delivery. After validation of the various suppliers' service stable supply capabilities, we acquire the needed materials and parts from the supplier offering the best terms. Our procurement department establishes an oversight process by appointing individuals to conduct periodic market research of key price points. There is a standard procedure for conducting said bidding process and accepting the bids to insure that all of the purchasing procedures are being strictly followed. We enter into long-term contracts with certain suppliers to lock in prices and send purchase orders for each delivery when necessary. Our long-term supply contracts do not contain any minimum unconditional purchase requirements.

## Major Suppliers

The tables below list our top five suppliers as of December 31, 2010

### Major Suppliers of Materials and Parts for Our Own Products

| Item                      | Suppliers  | Amount<br>Purchased<br>in 2010<br>(in thousands)<br>(\$) | Percentage<br>of Total<br>Purchase |
|---------------------------|--|--|------------------------------------|
| Electronic parts          | Beijing Huataichuang Technology Co., Ltd.        | 220  | 11.5%                              |
| Electric box              | Beijing Qingxianfangzheng Electric Box Co., Ltd. | 211  | 11.0%                              |
| Infra red flame detectors | Shandong Automatic System Engineering Co., Ltd.  | 167  | 8.7%                               |
| Cable                     | Nanjing Xianbang Technology Co, Ltd.             | 168  | 8.8%                               |
| Copper                    | Xinlide (Tianjin) Metal Manufacture Co, Ltd.     | 68   | 3.5%                               |
| Total                     |  | 835  | 43.6%                              |

## Major Suppliers for Third Party Products of Our Fire Safety Systems

| Item                               | Suppliers   | Amount Purchased in 2010 (in thousands) (\$) | Percentage of Total Purchase |
|------------------------------------|---|--|------------------------------|
| Sprayer, valves, gas extinguishers | Tianjin Tianxiao Security Equipment Corporation           | 3,887  | 20.6%                        |
| Fire prevention materials          | Wuhan Chenjie Technology Co., Ltd.                        | 2,956  | 15.6%                        |
| Cable                              | Beijing Kexun Cable Co., Ltd                              | 650  | 3.5%                         |
| Fire prevention materials          | Shanghai Pudong Special Fire Safety Equipment Corporation | 573  | 3.1%                         |
| Pipes                              | Tianjin Shengdefa Metal Material Co., Ltd                 | 471  | 2.6%                         |
| Total                              |   | 8537   | 45.4%                        |

## Our Competition

The fire safety market in China is intensely competitive and includes thousands of companies. We compete primarily in providing total fire safety solutions including engineering and installations to end customers. We also compete in the market for providing fire safety products.

The market for the design and installation of fire safety systems includes numerous small and mostly regional competitors. Consequently, we believe that our leading position in the industry has enabled us to win a high percentage of our bids (e.g., around 60-70% of bids in the iron and steel industry). We compete on design, technology, track record, price, quality of products, expertise and ability to complete the job in time. We believe that the fact that we use our own products also adds to our competitive positioning. While these factors play a less significant role in bidding for smaller jobs, we have twice been recognized as the industry leader by the China Association of Fire Prevention based on numerous significant factors including total revenue and profit. Foreign competitors normally do not engage in system integration due to their disadvantage in labor costs and the requirement of Chinese certificates.

We compete with both foreign competitors and local manufacturers for our products. Foreign-made products have historically had an advantage over Chinese-made products because of superior technology and quality. We believe that the demand for foreign products has begun to decline because of improvements in Chinese technology and as the technology and quality gaps narrow, the price advantage that Chinese-made products typically have has increased demand for Chinese-made products. We have developed numerous patented products with technological superiority over our competitors. Our China-based competitors tend to focus on low-end and technologically less sophisticated products that have lower quality and are not suitable for large projects. Most of the China-based companies have lower operating expenses and often compete with lower pricing.

Although we are currently successful in providing total fire safety solutions to our customers, there is no assurance that we will continue to be able to do so in the future. We have been successful in the iron and steel, power and petrochemical industries, but as we move into new industrial sectors, our lack of proprietary products that may be required by those industries may limit our market acceptance.

## Our Employees

As of December 31, 2010, we employed 465 full-time employees. Approximately 10.1% of our employees are management personnel, 4.5% are R&D staff members and 12.7% are sales staff members. Approximately 57.0% of

our employees have college degrees or higher.

Under Chinese law, our employees have formed labor unions which serve to protect employees' rights, aim to assist in the fulfillment of our economic objectives, encourage employee participation in management decisions and assist in mediating disputes. We believe that we maintain a satisfactory working relationship with our employees and have not experienced any significant labor disputes or any difficulty in recruiting staff for our operations.

As required by applicable Chinese law, we have entered into employment contracts with all of our employees. We have also entered into confidentiality agreements with all of our employees under which our employees are prohibited from disclosing confidential information of the Company or using it for purposes other than the benefit of the Company. Directors, officers, mid-level managers and certain key employees in sales and R&D are required to sign a non-compete agreement that prohibits them from competing with the Company while they are employees of the Company and within two years after their employment with the Company is terminated.

Our employees in China participate in a state pension arrangement organized by Chinese municipal and provincial governments. We are required to contribute to this arrangement at the rate of 20% of the average monthly salary. In addition, we are required by Chinese law to cover employees in China with other types of social insurances. Our total contribution may amount to 30% of the average monthly salary of an employee. We have purchased social insurance for all of our employees. In the event that any current employee, or former employee, files a complaint with the Chinese government, we may be required to purchase insurance for said employee, and we may be subject to administrative fines. We believe that such fines, if imposed, are immaterial.

#### Item 1A. Risk Factors

##### Cautionary Statement Regarding Future Results, Forward-Looking Information And Certain Important Factors

In this report we make, and from time to time we will otherwise make, written and oral statements regarding our business and its prospects, such as projections of future performance, statements of management's plans and objectives, forecasts of market trends, and other matters that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements containing the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimates," "projects," "believes," "expects," "anticipates," "intends," "target," "goal," "plans," "objective," "should" or similar expressions identify forward-looking statements, which may appear in documents, reports, filings with the Securities and Exchange Commission, news releases, written or oral presentations made by officers or other representatives made by us to analysts, stockholders, investors, news organizations and others, and discussions with management and other of our representatives. For such statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Our future results, including results related to forward-looking statements, involve a number of risks and uncertainties. No assurance can be given that the results reflected in any forward-looking statements will be achieved. Any forward-looking statement speaks only as of the date on which such statement is made. Our forward-looking statements are based upon assumptions that are sometimes based upon estimates, data, communications and other information from suppliers, government agencies and other sources that may be subject to revision. Except as required by law, we do not undertake any obligation to update or keep current either (i) any forward-looking statement to reflect events or circumstances arising after the date of such statement, or (ii) the important factors that could cause our future results to differ materially from historical results or trends, results anticipated or planned by us, or which are reflected from time to time in any forward-looking statement.

In addition to other matters identified or described by us from time to time in filings with the SEC, there are several important factors that could cause our future results to differ materially from historical results or trends, results anticipated or planned by us, or results that are reflected from time to time in any forward-looking statement. Some of these important factors include the risk factors below.

An investment in our Common Stock is speculative and involves a high degree of risk. You should carefully consider the risks described below and the other information in this Form 10-K before purchasing any of our Common Stock. If any of the events described in the risk factors below actually occur, our business, financial condition or results of

operations could suffer significantly. In such case, the value of your investment could decline and you may lose all or part of the money you paid to buy our Common Stock.

#### Risks Related To Our Business

Disruptions in the capital and credit markets related to the current national and worldwide financial crisis, which may continue indefinitely or intensify, could adversely affect our results of operations, cash flows and financial condition, or those of our customers and suppliers.

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The current disruptions in the capital and credit markets may continue indefinitely or intensify, and adversely impact our results of operations, cash flows and financial condition, or those of our customers and suppliers. These disruptions could adversely affect our ability to draw on our bank revolving credit facility, which is dependent on the ability of the banks that are parties to the facility to meet their funding commitments. Those banks may not be able to meet their funding commitments to us if they experience shortages of capital and liquidity. Disruptions in the capital and credit markets as a result of uncertainty, changing or increased regulation, reduced alternatives or failures of significant financial institutions could adversely affect our access to liquidity needed to conduct or expand our businesses or conduct acquisitions or make other discretionary investments, as well as our ability to effectively hedge our currency or interest rate. Such disruptions may also adversely impact the capital needs of our customers and suppliers, which, in turn, could adversely affect our results of operations, cash flows and financial condition.

Our products and services have relied on a few industries. We may not be able to increase the market for our products and services in other industries.

Presently, our products and services are mainly sold to the iron and steel, traditional power generation, petrochemical and nuclear power industries. Our products and services, therefore, depend heavily on a limited number of industries. Our growth potential may be limited if we cannot expand the market for our products and services. Although we have increased our research and development to expand the range of application of our products and services, there is no assurance that we will succeed in our effort.

Price increases of raw materials such as copper and steel could increase the cost of our products and reduce our profit margin.

Copper is the major material for our linear heat detectors and stainless steel is the major material for our fire extinguishing nozzles. In the last three years, the prices of copper and steel have fluctuated substantially as have other raw materials. Although we have managed to minimize the impact of such fluctuation in the past by passing the cost increase on to our customers, there is no assurance that we will be able to do so in the future. If the price for copper and steel increases more significantly and we cannot increase our selling price, our profit margin could decrease significantly.

We may not be able to secure financing needed for future operating needs on acceptable terms, or on any terms at all.

From time to time, we may seek additional financing to provide the capital required to maintain or expand our design and production facilities, research and development initiatives and equipment and/or working capital, as well as repay outstanding loans if cash flow from operations is insufficient to do so. We cannot predict with certainty the timing or amount of any such capital requirements. If such financing is not available on satisfactory terms, we may be unable to expand our business or to develop new business as the rate desired, and our operating results may suffer. If we are able to incur debt, we may be subject to certain restrictions imposed by the terms of the debt and the repayment of such debt may limit our cash flow and our ability to grow. If we are unable to incur debt, we may be forced to issue additional equity, which could have a dilutive effect of the then current holders of equity.

Our strategic alliances may not achieve their objectives.

Currently, we have agreements with two multinational companies to supply our linear heat detectors. The strategic alliances are intended to enhance or complement our technology or work in conjunction with our technology, increase our manufacturing capacity, provide additional components or materials, and develop, introduce and distribute products using our technology and know-how. If these alliances do not achieve their objectives or parties to our strategic alliances do not perform as contemplated, our growth may be adversely affected.

Expansion of our business may put added pressure on our management and operational infrastructure impeding our ability to meet any increased demand for our products and services and possibly hurting our operating results.

Our business plan is to significantly grow our operations to meet anticipated growth in demand for our products and services. Our planned growth includes the increase of our line of products and expansion of sales in our existing markets as well as entry into new markets over the next few years. Growth in our business may place a significant strain on our personnel, management, financial systems and other resources. The evolution of our business also presents numerous risks and challenges, including:

the continued acceptance of our products and services by the iron and steel, power and petrochemical industries;

our ability to successfully and rapidly expand sales to potential customers in response to potentially increasing demand;

the costs associated with such growth, which are difficult to quantify, but could be significant;

rapid technological change; and

the highly competitive nature of the industrial fire safety industry.

If we are successful in obtaining rapid market growth of our products and service, we will be required to deliver large volumes of quality products and services to customers on a timely basis at a reasonable cost. Meeting any such increased demands will require us to expand our manufacturing facilities, to increase our ability to purchase raw materials, to increase the size of our work force, to expand our quality control capabilities and to increase the scale upon which we provide our products and services. Such demands would require more capital and working capital than we currently have available and we may be unable to meet the needs of our customers.

Our business depends on our ability to protect our intellectual property effectively. If any of our patents are not protected, or any of our trade secrets are divulged, we may lose our competitive edge.

The success of our business depends in substantial measure on the legal protection of the patents and other proprietary rights in the technology we hold. We hold issued patents and pending patent applications in China related to technologies important to our business. Monitoring infringement of intellectual property rights is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our intellectual property and know-how in China where, in comparison to the United States, the laws may be difficult to enforce to fully protect our proprietary rights. The validity and breadth of claims in patents and trade secrets involve complex legal and factual questions and, therefore, the extent of their enforceability and protection is highly uncertain. Issued patents or patents based on pending patent applications or any future patent applications or trade secrets may not exclude competitors or may not provide a competitive advantage to us. In addition, patents issued or licensed to us may not be held valid if subsequently challenged and others may claim rights in or ownership of such patents. Furthermore, we cannot ensure that our competitors have not developed or will not develop similar products, will not duplicate our products, or will not design around any patents issued to or licensed by us.

We claim proprietary rights in various unpatented technologies, know-how, trade secrets and trademarks relating to products and manufacturing processes. We protect our proprietary rights in our products and operations through contractual obligations, including nondisclosure agreements. If these contractual measures fail to protect our proprietary rights, any advantage those proprietary rights provided to us would be negated. Some of our products are based on formulas. The formulas are maintained as trade secrets and are revealed only to a small number of technical and management personnel. The trade secrets provide us with a competitive edge in the linear heat technology and to the best of our knowledge, no other manufacturers have successfully developed such technology. If any of the trade secrets are divulged, we could lose our competitive edge in the linear heat technology and others.

We receive a significant portion of our revenues from a small number of customers. Our business will be harmed if our customers reduce their orders from us or if significant orders are not completed successfully.

A significant amount of our revenues are derived from only a small number of customers mainly in the iron and steel, traditional power, petrochemical and nuclear power industries. In aggregate, our five largest customers in our total solutions and products businesses accounted for approximately 73.8% and 36.8%, respectively, of our revenues from these segments in fiscal 2010. Dependence on a few customers could make it difficult to negotiate attractive prices for our products and could expose us to the risk of substantial losses if a single dominant customer stops purchasing our products. If we lose any customers and are unable to replace them with other customers that purchase a similar amount of our products and services, our revenues and net income would decline considerably.



In February 2010, we entered into an agreement with Wuhan Iron and Steel (Group) Corporation (“WISCO”), pursuant to which we have agreed to complete the retrofitting total solution project of the fire protection facilities for WISCO’s thirty-two plants located in Qingshan, Hubei Province, by the end of 2011 for approximately \$92 million. We believe that this total solution project for WISCO will account for a significant portion of our total revenue in the near future. Any unexpected disruption or slowdown in the execution of the obligations of this agreement could result in a material adverse affect on our business, financial condition and results of operations and cause us to fall short of our financial guidance in the future.

We extend relatively long payment terms for accounts receivable. If any of our customers fails to pay us, our revenues may be affected as a result.

Our standard practice is to charge our customers 10%-30% of the contract amount up front and collect the balance according to a schedule based on the progress of a project. However, many of our customers are state-owned enterprises and may be slow in their payment process. As a result of the size of many of our contracts, their delayed payments adversely affect our cash flow and our ability to fund our operations out of our operating cash flow. In addition, although we attempt to establish appropriate reserves for our receivables, those reserves may not prove to be adequate in view of actual levels of bad debts. The failure of our customers to pay us in a timely manner could negatively affect our working capital, which could, in turn, adversely affect our cash flow. Although, on occasion payments have been delayed, no customer has failed to pay us however, there is no assurance that they will be able to pay in the future.

Our business may be severely disrupted if we lose the services of our key executives and employees or fail to add new senior and middle managers to our management.

Our future success is heavily dependent upon the continued service of our key executives, particularly Mr. Weigang Li, our Chairman, Mr. Brian Lin, our Chief Executive Officer, Tongzhuo Qin, our Chief Financial Officer, Mr. Weishe Zhang, our Vice President of Strategic Planning, Mr. Robert Yuan, our Principal Accounting Officer and several other key sales and project management executives in our subsidiary Sureland Industrial Fire Safety Limited. Our future success is also dependent upon our ability to attract and retain qualified senior and middle managers to our management team. If one or more of our current or future key executives and employees are unable or unwilling to continue in their present positions, we may not be able to easily replace them, and our business may be severely disrupted. In addition, if any of these key executives or employees joins a competitor or forms a competing company, we could lose customers and suppliers and incur additional expenses to recruit and train personnel. Each of our executive officers has entered into an employment agreement with us. We also rely on a number of key technology staff for the operation of our Company. Given the competitive nature of our industry, the risk of key technology staff leaving our Company is high and could disrupt our operations.

We may seek to make acquisitions that prove unsuccessful or strains or diverts our resources.

We may seek to expand our business through the acquisition of related businesses and assets. We may not be able to complete any acquisitions on favorable terms or at all. Acquisitions present risks that could materially and adversely affect our business and financial performance, including:

- the diversion of our management's attention from our everyday business activities;

- the contingent and latent risks associated with the past operations of, and other unanticipated problems arising in, the acquired business; and

- the need to expand management, administration, and operational systems.

If we make such acquisitions we cannot predict whether:

- we will be able to successfully integrate the operations and personnel of any new businesses into our business;

- we will realize any anticipated benefits of completed acquisitions; or

there will be substantial unanticipated costs associated with acquisitions, including potential costs associated with environmental liabilities undiscovered at the time of acquisition.

In addition, future acquisitions by us may result in:

potentially dilutive issuances of our equity securities;

the incurrence of additional debt;

restructuring charges; and

the recognition of significant charges for depreciation and amortization related to intangible assets.

We will incur increased costs as a result of changes in laws and regulations relating to corporate governance matters.

As a public reporting company, we will need to comply with the Sarbanes-Oxley Act of 2002 and the related rules and regulations adopted by the SEC and by The NASDAQ Capital Market, including expanded disclosures, accelerated reporting requirements and more complex accounting rules. Compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and other requirements will increase our costs and require additional management resources. Additionally, these laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers. We are presently evaluating and monitoring developments with respect to these laws and regulations and cannot predict or estimate the amount or timing of additional costs we may incur to respond to their requirements.

We may not be able to achieve and maintain an effective system of internal control over financial reporting, a failure which may prevent us from accurately reporting our financial results or detecting and preventing fraud.

We are subject to reporting obligations under the U.S. securities law. Beginning with our annual report on Form 10-KSB for the fiscal year ending December 31, 2007, we will be required to prepare a management report on our internal control over financial reporting containing our management's assessment of the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on the effectiveness of our internal control over financial reporting. Our management may conclude that our internal control over our financial reporting is not effective. Moreover, even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may still decline to attest to the effectiveness or may issue a report that is qualified if it is not satisfied with our controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us. Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future.

#### Risks Related To Our Industry

Our market will open to foreign companies. China's commitments under the World Trade Organization ("WTO") may intensify competition.

In connection with its accession to the WTO, China made many commitments including opening its markets to foreign products and services, allowing foreign companies to conduct distribution businesses and reducing customs duties. As a result, foreign manufacturers may ship more industrial fire safety products into China or they may establish manufacturing facilities and service centers in China. Competition from foreign companies may squeeze our profit margins and our business results will suffer as a result.

The fire protection total solution market is fragmented and susceptible to consolidation, which could adversely affect us.

We engage in providing fire protection total solutions that consist of the design and installation of fire safety systems. The market is fragmented in the sense that there are many, typically small, suppliers. The market may be subject to consolidation and, if so, we may not be a major player. If so, our fire protection total solution business could suffer and this business is a major source of sales of our own products and profitability.

Our customers will decrease their capital expenditure if China's economy slows down. Such a slowdown may affect our growth.

Our industry is cyclical in nature and highly dependent on economic conditions. Over the last three decades, China's economy has been growing at an average annual rate of 9-10%. There can be no assurance that China's economy will continue to grow at such pace in the future. If the economy slows down, our customers will cut their capital expenditure and, hence, order less of our products and services. Our growth may suffer as a result.

High margins for the industrial fire safety business will attract more businesses to enter this field. Our business could suffer as a result of more competition.

So far, our business has enjoyed relatively high profit margins due to the fact that we have concentrated in industrial fire safety. Such high margins will attract more businesses to enter into this field. As a result, competition may intensify and our profits may drop significantly.

If we cannot compete successfully for market share against other industrial fire safety products companies, we may not achieve sufficient product revenues, and our business will suffer.

The market for our products and services is characterized by intense competition and rapid technological advances. Our products and services compete with a multitude of products and services developed, manufactured and marketed by others and we expect competition from new market entrants in the future, including as a result of the WTO. Existing or future competing products may provide better quality and technology, greater utility or lower cost or other benefits from their intended uses than our products, or may offer comparable performance at a lower cost. If our products fail to capture and maintain market share, we may not achieve sufficient product revenues, and our business could suffer.

Gross margins could be lower in new industrial sectors.

We enjoy relatively high margins in our main markets including iron and steel, power generation and petrochemical. As we start bidding for projects in new industrial sectors including subways, highway tunnels, and nuclear plants, we might not be able to sell our products at the gross margins that we enjoy in our main markets. Our overall gross margin could be adversely affected.

#### Risks Related To Doing Business in China

Changes in China's political or economic situation could harm us and our operational results.

Economic reforms adopted by the Chinese government have had a positive effect on the economic development of the country, but the government could change these economic reforms or any of the legal systems at any time. This could either benefit or damage our operations and profitability. Some of the things that could have this effect are:

- level of government involvement in the economy;

- control of foreign exchange;

- methods of allocating resources;

- balance of payments position;

- international trade restrictions;

- international conflict; and

- tax policy.

The Chinese economy differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development, or OECD, in many ways. The economic reforms in China have been conducted under a tight grip of the Chinese government. As a result of these differences, we may not develop in the same way or at the same rate as might be expected if the Chinese economy were similar to those of the OECD member countries.

Our business is largely subject to the uncertain legal environment in China and your legal protection could be limited.

The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which precedents set in earlier legal cases are not generally used. The overall effect of legislation enacted over the past 20 years has been to enhance the protections afforded to foreign invested enterprises in China. However, these laws, regulations and legal requirements are relatively recent and are evolving rapidly, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to foreign shareholders, such as the right of foreign invested enterprises to hold licenses and permits such as requisite business licenses. In addition, all of our executive officers and our directors are residents of China and not of

the U.S., and substantially all the assets of these persons are located outside the U.S. As a result, it could be difficult for shareholders to affect service of process in the U.S., or to enforce a judgment obtained in the U.S. against us or any of these persons.

You may face difficulties in protecting your interests, and your ability to protect your rights through the U.S. federal courts may be limited. Our operating subsidiaries are incorporated in non-U.S. jurisdictions, we conduct substantially all of our operations in China, and all of our officers reside outside the United States.

We conduct substantially all of our operations in China through our wholly owned subsidiaries in China. All of our officers reside outside the United States and some or all of the assets of those persons are located outside of the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in China in the event that you believe that your rights have been infringed upon under the securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the PRC may render you unable to enforce a judgment against our assets or the assets of our directors and officers. As a result of all of the above, our public stockholders may have more difficulty in protecting their interests through actions against our management, directors or major stockholders than would stockholders of a corporation doing business entirely within the United States.

The Chinese government exerts substantial influence over the manner in which we must conduct our business activities.

China has only recently permitted provincial and local economic autonomy and private economic activities. The Chinese government has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy through regulation and state ownership. Our ability to operate in China may be harmed by changes in its laws and regulations, including those relating to taxation, import and export tariffs, environmental regulations, land use rights, property and other matters. We believe that our operations in China are in material compliance with all applicable legal and regulatory requirements. However, the central or local governments of these jurisdictions may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations. Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in China or particular regions thereof, and could require us to divest ourselves of any interest we then hold in Chinese properties.

Future inflation in China may inhibit our activity to conduct business in China.

In recent years, the Chinese economy has experienced periods of rapid expansion and high rates of inflation. During the past ten years, the rate of inflation in China has been as high as 20.7% and as low as -2.2%. These factors have led to the adoption by the Chinese government, from time to time, of various corrective measures designed to restrict the availability of credit or regulate growth and contain inflation. While inflation has been more moderate since 1995, high inflation may in the future cause the Chinese government to impose controls on credit and/or prices, or to take other action, which could inhibit economic activity in China, and thereby harm the market for our products.

We have limited insurance coverage and may incur losses due to business interruptions resulting from natural and man-made disasters, and our insurance may not be adequate to cover liabilities resulting from accidents or injuries that may occur.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited commercial insurance products. We carry auto insurance on our vehicles. We do not carry any product liability insurance or property insurance on our office buildings, our industrial sites or other property. We believe that current facilities are adequate for our current and immediately foreseeable operating needs. We do not have any policies



regarding investments in real estate, securities or other forms of property. We have determined that balancing the risks of disruption or liability from our business, or the loss or damage to our property, including our facilities and equipment, the cost of insuring for these risks on the one hand, and the difficulties associated with acquiring such insurance on commercially reasonable terms on the other hand, makes it impractical for us to have such insurance.

Should any natural catastrophes such as earthquakes, floods, or any acts of terrorism occur in city of Beijing, PRC, where our primary operations are located and most of our employees are based, or elsewhere, we might suffer not only significant property damage, but also loss of revenues due to interruptions in our business operations. The occurrence of a significant event for which we are not fully insured or indemnified, and/or the failure of a party to meet its underwriting or indemnification obligations, could materially and adversely affect our operations and financial condition. Moreover, no assurance can be given that we will be able to maintain adequate insurance in the future at rates we consider reasonable.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

The majority of our revenues will be settled in Renminbi and any future restrictions on currency exchanges may limit our ability to use revenue generated in Renminbi to fund any future business activities outside China or to make dividend or other payments in U.S. dollars. Although the Chinese government introduced regulations in 1996 to allow greater convertibility of the Renminbi for current account transactions, significant restrictions still remain, including primarily the restriction that foreign-invested enterprises may only buy, sell or remit foreign currencies after providing valid commercial documents, at those banks in China authorized to conduct foreign exchange business. In addition, conversion of Renminbi for capital account items, including direct investment and loans, is subject to governmental approval in China, and companies are required to open and maintain separate foreign exchange accounts for capital account items. We cannot be certain that the Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the Renminbi.

Cessation of the income tax reduction and exemption for our subsidiaries may have an adverse impact on our net profits.

From January 1, 2008, under new Chinese income tax law, a company would ordinarily be subject to the PRC income tax rates of 25%. However, the law also provides tax exemption or reduction for high-tech businesses and foreign invested enterprises (“FIE”). As a result, some of our subsidiaries are currently enjoying a tax reduction of and/or exemption from state and local income tax. For details, please see the income taxes section of “Management Discussion and Analysis.” If the Chinese government decides to change the tax law, our revenues and profit could suffer.

A new Chinese law may impact our ability to make acquisitions of Chinese businesses.

On August 8, 2006, six PRC regulatory agencies namely, the PRC Ministry of Commerce, the State Assets Supervision and Administration Commission, the State Administration for Taxation, the State Administration for Industry and Commerce, the China Securities Regulatory Commission (“CSRC”), and the State Administration of Foreign Exchange, jointly adopted the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the “New M&A Rule”), which became effective on September 8, 2006. The New M&A Rule purports, among other things, to require offshore Special Purpose Ventures, formed after the effective date, for overseas listing purposes, through acquisitions of PRC domestic companies and controlled by PRC companies or individuals, to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange.

The Company intends to make acquisitions of Chinese businesses in the future. There are uncertainties regarding the interpretation and application of the current or future PRC laws and regulations, including the New M&A Rule and these uncertainties could make it difficult or impossible to make acquisitions of Chinese businesses in the future.

Foreign investment policy changes may adversely affect our income and results of operations.

On March 16, 2007, China’s parliament, the National People’s Congress, adopted the Enterprise Income Tax Law, which took effect on January 1, 2008. The new income tax law sets unified income tax rates for domestic and foreign companies at 25% and abolishes the favorable policy for foreign invested enterprises. After January 1, 2008, newly established foreign invested enterprises will not enjoy favorable tax treatment permitted under prior tax laws. Some of our subsidiaries are benefiting from the preferred tax rates for foreign companies and will follow the new tax rate when their respective term of preferred tax rates expires. Our net income margin will be affected at that time.

If the government changes its policies on the value added tax rebate, our revenues and profit could be adversely affected.

Under Chinese tax law, businesses should pay a value added tax at a 17% rate. To support the development of the software industry, the Chinese government has instituted policies to rebate value added tax charged for software certified by the government up to 14%. As a result, our subsidiary Hua An Limited, is paying its value added tax at an effective rate of 3% for the software they sell. However, the Chinese government changes its policies from time to time. If the Chinese government changes the policies currently in place for the value added tax rebate, our revenues and our profit could suffer.

The value of our securities will be affected by the foreign exchange rate between U.S. dollars and Renminbi.

The value of our Common Stock will be affected by the foreign exchange rate between U.S. dollars and Renminbi, and between those currencies and other currencies in which our sales may be denominated. For example, to the extent that we need to convert U.S.

dollars into Renminbi for our operational needs and should the Renminbi appreciate against the U.S. dollar at that time, our financial position, the business of the company, and the price of our Common Stock may be harmed. Conversely, if we decide to convert our Renminbi into U.S. dollars for the purpose of declaring dividends on our Common Stock or for other business purposes and the U.S. dollar appreciates against the Renminbi, the U.S. dollar equivalent of our earnings from our subsidiaries in China would be reduced.

#### Risks Related to the Market for Our Stock

The trading prices of many companies that have business operations only in China have been volatile which may result in large fluctuations in the price of our Common Stock and losses for shareholders.

The stock market has experienced significant price and volume fluctuations that have particularly affected the trading prices of equity securities of many companies that have business operations only in China. These fluctuations have often been unrelated or disproportionate to the operating performance of many of these companies. Any negative change in the public's perception of these companies could depress our stock price regardless of our operating results. The market price of our Common Stock has been and may continue to be volatile. We expect our stock price to be subject to fluctuations as a result of a variety of factors, including factors beyond our control. These factors include:

- actual or anticipated variations in our quarterly operating results;
- announcements of technological innovations or new products or services by us or our competitors;
- announcements relating to strategic relationships or acquisitions;
- additions or terminations of coverage of our Common Stock by securities analysts;
- statements by securities analysts regarding us or our industry;
- conditions or trends in the our industry; and,
- changes in the economic performance and/or market valuations of other industrial fire safety companies.

The prices at which our Common Stock trades will affect our ability to raise capital, which may have an adverse affect on our ability to fund our operations.

We do not intend to pay any dividends on our Common Stock in the foreseeable future.

We currently intend to retain all future earnings, if any, to finance our current and proposed business activities and do not anticipate paying any cash dividends on our Common Stock in the foreseeable future. We may also incur indebtedness in the future that may prohibit or effectively restrict the payment of cash dividends on our Common Stock.

Certain stockholders can exert control over the Company and may not make decisions that further the best interests of all stockholders.

Our officers, directors and principal stockholders (greater than 5% stockholders) together will own an aggregate of approximately 59.9% of our outstanding Common Stock on a fully diluted basis. Consequently, these stockholders, if they act individually or together, may exert a significant degree of influence over our management and affairs and

over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. In addition, this concentration of ownership may delay or prevent a change of control of us and might affect the market price of our Common Stock, even when a change of control may be in the best interest of all stockholders. Furthermore, the interests of this concentration of ownership may not always coincide with our interests or the interests of other stockholders, and accordingly, they could cause us to enter into transactions or agreements which we would not otherwise consider.

Item 1B. Unresolved Staff Comments

There are no unresolved comments from the SEC.

## Item 2. Properties

All land in China is owned by the State. Individuals and companies are permitted to acquire rights to use land or land use rights for specific purposes. In the case of land used for industrial purposes, the land use rights are granted for a period of 50 years. This period may be renewed at the expiration of the initial and any subsequent terms. Granted land use rights are transferable and may be used as security for borrowings and other obligations.

We currently own approximately 23,573 square meters of land in Beijing, consisting of manufacturing facilities, employee quarters, warehouses, and office buildings. We also own approximately 945 square meters of office space in downtown Beijing, which serves as our headquarters.

## Item 3. Legal Proceedings

In 2009, we filed four lawsuits against four different companies for the infringement of our intellectual properties in linear heat detectors and three of these four lawsuits had been settled in our favor. We expect the one pending case will be settled in our favor. In 2009, we were counter-sued by one of the companies we filed suit against in two cases for the invalidation of our intellectual properties in linear heat detectors. As of March 10, 2011, these two cases are pending. We expect these two pending cases to be settled in our favor.

In 2010, we filed six lawsuits against five different companies for the infringement of our intellectual properties in linear heat detectors. By March 10, 2011, three of these six lawsuits had been settled in our favor and the other three cases are still pending. We expect the three pending cases filed in 2010 will be settled in our favor in the future. In 2010, we were counter-sued by two of the companies we filed suits against for the invalidation of our intellectual properties in linear heat detectors and all three cases were settled in our favor.

Although we cannot predict with certainty the result of the litigation matters, we believe that the outcomes of the above described matters will not have a material adverse effect on our business or results of operations.

## PART II

### Item 5. Market For Registrant's Common Equity, Related Shareholder Matters, And Issuer Purchases Of Equity Securities

#### Market Price Information

Our Common Stock has been quoted on The NASDAQ Capital Market under the symbol "CFSG" since July 16, 2007. The following table provides the high and low sales prices for our Common Stock as reported for the periods indicated.

| Year ending December 31,<br>2011 | High    | Low     |
|----------------------------------|---------|---------|
| First Quarter (up to March 11)   | \$ 7.33 | \$ 5.45 |

| Year ending December 31,<br>2010 | High     | Low      |
|----------------------------------|----------|----------|
| First Quarter                    | \$ 15.80 | \$ 10.94 |
| Second Quarter                   | \$ 14.60 | \$ 9.18  |
| Third Quarter                    | \$ 9.60  | \$ 6.67  |
| Fourth Quarter                   | \$ 8.76  | \$ 6.40  |

| Year ending December 31,<br>2009 | High     | Low      |
|----------------------------------|----------|----------|
| First Quarter                    | \$ 8.73  | \$ 6.11  |
| Second Quarter                   | \$ 14.87 | \$ 7.69  |
| Third Quarter                    | \$ 21.72 | \$ 10.33 |
| Fourth Quarter                   | \$ 19.60 | e 12.14  |

On March 11, 2011, the last reported sale price of our Common Stock on The NASDAQ Capital Market was \$6.24 per share.

#### Shareholders

As of March 11, 2011, we had outstanding 27,855,934 shares of Common Stock, held by approximately 1,000 stockholders of record and beneficially.

#### Dividend Policy

To date, we have neither declared nor paid any cash dividends on shares of our Common Stock. We presently intend to retain earnings to finance the operation and expansion of our business and do not anticipate declaring cash dividends in the foreseeable future.

#### Repurchases of Equity Securities

No repurchases of our Common Stock were made in any month within the fourth quarter of the fiscal year covered by this report.

#### Item 6. Selected Financial Data

You should read the following selected consolidated financial data in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” the financial statements and related notes, and the other financial information included in this report.

#### CONSOLIDATED STATEMENTS OF INCOME

|  | Years Ended December 31 |              |              |              |              |
|--|-------------------------|--------------|--------------|--------------|--------------|
|  | 2010                    | 2009         | 2008         | 2007         | 2006         |
| Revenues   | 79,976,682              | \$81,181,198 | \$69,079,119 | \$46,753,837 | \$32,455,036 |
| Cost of revenues   | 38,698,240              | 34,127,922   | 29,581,246   | 21,090,854   | 16,226,307   |
| Gross profits  | 41,278,442              | 47,053,276   | 39,497,873   | 25,662,983   | 16,228,729   |
| Operating expenses   | 23,776,073              | 19,468,840   | 15,931,124   | 10,776,553   | 8,250,285    |
| Income from operations   | 17,502,369              | 27,584,436   | 23,566,749   | 14,886,430   | 7,978,444    |
| Other income (expenses)  | 1,060,616               | 940,704      | 1,184,526    | 1,920,287    | (926,597 )   |
| Income before provision for income taxes and noncontrolling interest | 18,562,985              | 28,525,140   | 24,751,275   | 16,806,717   | 7,051,847    |
| Provision for income taxes   | 3,210,378               | 4,165,548    | 47,423       | 5,081        | 82,206       |
| Less: Net income (loss) attributable to noncontrolling interest      | (85,328 )               | (55,244 )    | -            | -            | -            |
| Net income attributable to controlling interest                      | 15,437,935              | 24,414,836   | 24,703,852   | 16,801,636   | 6,969,641    |
| Comprehensive income   | 19,464,303              | \$24,433,912 | \$28,440,879 | \$19,304,231 | \$7,551,573  |
| Weighted average number of shares                                    | 27,618,465              | 27,590,523   | 27,568,214   | 26,873,742   | 24,340,196   |
| Earnings per share   | 0.56                    | \$0.88       | \$0.90       | \$0.63       | \$0.29       |
| Weighted average number of shares Diluted                            | 29,568,429              | 28,311,955   | 28,210,620   | 27,721,171   | 24,539,414   |
| Earnings per share Diluted   | 0.52                    | \$0.86       | \$0.88       | \$0.61       | \$0.28       |

#### CONSOLIDATED BALANCE SHEETS

|                           | Years Ended December 31 |            |            |            |           |
|---------------------------|-------------------------|------------|------------|------------|-----------|
|                           | 2010                    | 2009       | 2008       | 2007       | 2006      |
| Cash and cash equivalents | 28,151,689              | 34,976,880 | 26,655,333 | 17,110,449 | 9,426,091 |



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|  |            |            |            |            |            |
|--|------------|------------|------------|------------|------------|
| Accounts receivables – current, net of allowance | 41,840,062 | 30,989,569 | 25,826,343 | 16,525,161 | 13,211,721 |
| Receivables from related party                   | 2,448,066  | 551,792    | 466,223    | -          | -          |

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|                            |             |             |             |            |            |
|----------------------------|-------------|-------------|-------------|------------|------------|
| Inventories                | 6,713,448   | 5,360,520   | 6,538,938   | 4,048,283  | 4,190,830  |
| Total current assets       | 150,033,254 | 121,046,728 | 91,449,840  | 62,190,368 | 43,295,272 |
| Plant and equipment, net   | 9,641,119   | 8,617,521   | 8,445,254   | 6,568,250  | 3,529,808  |
| Total assets               | 171,535,816 | 138,366,191 | 105,408,918 | 71,646,427 | 48,308,828 |
| Total current liabilities  | 43,556,150  | 33,966,635  | 26,719,771  | 21,438,311 | 20,649,342 |
| Total shareholder's equity | 127,979,666 | 104,366,814 | 78,689,147  | 50,208,116 | 24,978,675 |

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

### General

The following discussion and analysis provides information which the management of China Fire & Security Group, Inc. believes to be relevant to an assessment and understanding of the Company's results of operations and financial condition. This discussion should be read together with the Company's financial statements and the notes to financial statements, which are included in this report.

### Overview

We are engaged in the design, development, manufacturing and sale of fire protection products and services for large industrial firms in China and international markets. We have developed a proprietary product line that addresses all aspects of industrial fire safety from fire detection to fire system control and extinguishing. The Company is one of the first companies in China to utilize high technology for fire protection and safety of its clients including iron and steel companies, power plants, petrochemical plants, as well as, special purpose construction companies in China and other international markets.

### Reorganization

We were organized as a Florida corporation on June 17, 2003.

On September 1, 2006, we entered into a share exchange agreement, pursuant to which we acquired all of the outstanding capital shares of China Fire Protection Group Inc. ("CFPG") in exchange for a controlling interest in our Common Stock. The transaction was completed on Oct 27, 2006.

CFPG was organized on June 2, 2006 for the purpose of acquiring all of the capital shares of Sureland Industrial Fire Safety Limited ("Sureland Industrial"), a Chinese corporation, and, Sureland Industrial Fire Equipment Co., Ltd. ("Sureland Equipment"), a Chinese corporation, which collectively engage in the design, development, manufacturing and sale of fire protection products and services for large industrial consumers in China. As a result of the transactions described above, both Sureland Industrial and Sureland Equipment became wholly-owned subsidiaries of China Fire Protection Group Limited ("CFPG"), and CFPG is a wholly-owned subsidiary of Unipro Financial Services, Inc., a Florida corporation ("Unipro").

On February 9, 2007, Unipro changed its name to China Fire & Security Group, Inc. and started trading on OTC Bulletin Board under its new ticker symbol CFSG. On July 16, 2007, China Fire & Security Group, Inc. began trading on Nasdaq Capital Market and retained the ticker symbol CFSG.

CFSG owns, through its wholly owned subsidiary China Fire Protection Group, Inc., Sureland Industrial and Sureland Equipment (jointly "Sureland"). Sureland is engaged primarily in the design, development, manufacture and sale in China of a variety of fire safety products for the industrial fire safety market as well as the design and installation of industrial fire safety systems that utilize a combination of fire safety products including its own fire safety products. To a minor extent, it also provides maintenance services for customers that use its industrial fire safety systems. Its

business is primarily in China, but it has gradually increased its business in other countries like India and Indonesia.

Sureland markets its industrial fire safety products and systems primarily to major companies in the iron and steel, power and petrochemical industries in China and international market. It has also completed projects for highway and railway tunnels, wine distilleries, tobacco warehouses and a nuclear reactor. It is expanding its business in the transportation, marine transport, nuclear energy, and public space markets. Its products can be readily adapted for use on marine transportation and in exhibition halls and theatres. It plans to expand its marketing efforts to secure business in these industries.

Sureland has internal research and development facilities engaged primarily in furthering fire safety technologies. It believes that its technologies allow it to offer cost-effective and high-quality fire safety products and systems. It has developed products for industrial fire detecting and extinguishing. It believes that it is the largest manufacturer in China that has successfully developed a comprehensive line of linear heat detectors.

In May 2009, Beijing Shian Kexin Technology Co., Ltd. (“Shian Kexin”) was incorporated in Beijing, China under the laws of the PRC with registered capital of RMB5,000,000 or approximately \$748,500. Shian Kexin is 100% owned by Sureland Industrial.

In May 2009, Shenyang Hongshida Electronics Co., Ltd. (“Hongshida”) was incorporated in Shenyang, Liaoning Province, China under the laws of the PRC with registered capital of RMB10,000,000 or approximately \$1,497,000. Hongshida is 80% owned by Beijing Hua An Times Fire Safety Technology Co., Ltd. (“Beijing Hua An”) with a 20% non-controlling interest owned by an unrelated party. Beijing Hua An is 100% owned by Sureland Industrial.

During the first quarter of 2010, our wholly-owned subsidiary, China Fire Protection Group, Inc. entered into an agreement with Zeetech System Private Limited (“Zeetech”), our subsidiary in which we control 100% (99% direct holding, 1% through nominee holding where the nominee agrees to hold the shares on behalf of CFPG), pursuant to which China Fire Protection Group Inc.’s entire interest (75%) in Sureland Industrial shall be transferred to Zeetech. On March 12, 2010, the restructuring transaction was approved by the Chinese Ministry of Commerce. Subsequent to the transfer, China Fire & Security Group, Inc. still holds 100% of the interest in Sureland Industrial through its subsidiaries.

During the fourth quarter of 2010, our wholly-owned subsidiary, China Fire Protection Group, Inc. entered into an agreement with Zeetech System Private Limited (“Zeetech”) pursuant to which Zeetech’s entire interest (75%) in Sureland Industrial shall be reverted back to China Fire Protection Group, Inc. On December 9, 2010, the reverse transaction was approved by the Chinese Ministry of Commerce. Subsequent to the transaction, China Fire & Security Group, Inc. still holds 100% of the interest in Sureland Industrial through its subsidiaries.

As of December 31, 2010, Sureland operated more than 26 sales and liaison offices in China.

Sureland has twice been ranked as the leading Chinese industrial fire safety company and the largest contractor by the China Association for Fire Prevention based on six major factors including total revenue, growth rate, net profit, return on assets, investment in research and development and intellectual property. Its key products include linear heat detectors and water mist extinguishers, whose sales volumes are the largest in China. Customers in over 20 provinces have utilized its products.

#### Critical Accounting Policies and Estimates

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements appearing at the end of this report, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating our reported financial results.

Certain of the Company’s accounting policies require higher degree of judgment than others in their application. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements:

#### Revenue recognition

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

1. Revenue recognition of total solution contracts: Historically more than 70% of our revenues are derived from long-term, fixed price total solution contracts for which revenues and estimated profits are recognized using the percentage of completion method of accounting. Under this method revenue recognized based upon the ratio that incurred costs to date bear to total estimated contract costs at completion with related cost of sales recorded as costs are incurred. Contract costs include all direct material and labor costs and those indirect costs related to contract performance. Selling and administrative costs are charged to expense as incurred. Risks and uncertainties inherent in the estimation process could affect the amounts reported in our financial statements. The key assumptions used in the estimate of costs to complete relate to the unit material cost, the quantity of materials to be used, the installation cost and those indirect costs related to contract performance. The estimate of unit material cost is reviewed and updated on a quarterly basis, based on the updated information available on the supply markets. The estimate of material quantity to be used for completion and the installation cost is also reviewed and updated on a quarterly basis, based on the updated information on the progress of projection execution. If the supply market conditions or the progress

of projection execution were different, it is likely that materially different amounts of contract costs would be used in the percentage of completion method of accounting. Thus the uncertainty associated with those estimates may impact our consolidated financial statements.

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 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.

In accordance with ASC 605-15, “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.

#### Foreign currency translation

The reporting currency of the Company is the U.S. dollar. The Company uses their local currency, Renminbi and Indian Rupee (“INR”), 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 consolidated statement of changes in equity.

Asset and liability accounts at December 31, 2010 were translated at 6.59 RMB to \$1.00 and 45.45 INR to \$1.00 as compared to 6.82 RMB to \$1.00 and 46.89 INR to \$1.00 at December 31, 2009 respectively. Equity accounts were stated at their historical rate. The average translation rates of RMB applied to income statements accounts for the year ended December 31, 2010, 2009 and 2008 were 6.78 RMB, 6.82 RMB and 6.94 RMB, respectively. The average translation rates of INR applied to income statements accounts for the years ended December 31, 2010 and 2009 were 45.87 INR and 48.85 INR, 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 sheets.

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 engaged in any currency trading or hedging transactions, although there is no assurance that the Company will not enter into such transactions in the future.

#### 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.

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, impairment of long-lived assets and the allowance for doubtful accounts. Management evaluates all of its estimates and judgments on an on-going basis.

Accounts receivable

Accounts receivable represents amounts due from customers for products sales, maintenance services and system contracting projects. The credit term is generally for a period of three months for major customers. Each customer has a maximum credit limit. The Company seeks to maintain strict control over its outstanding receivables. Overdue balances are reviewed regularly by senior management. In order to mitigate the adverse liquidity impact of the delays in customer payments, we can negotiate with our suppliers for a better payment term, in order to slow down our payments to our suppliers in the future. However, due to the limited

number of qualified suppliers available in the market, the potential delay in our payments to suppliers cannot significantly offset the adverse liquidity impact of the delays from our customer payments.

#### Allowance for doubtful accounts

We establish an allowance for doubtful accounts based on management's assessment of the collectability of our account receivables. A considerable amount of judgment is required in assessing the amount of the allowance. We consider the historical level of credit losses, apply percentages to aged receivable categories, make judgments about the creditworthiness of each customer based on ongoing credit evaluations, and monitor current economic trends that might impact the level of credit losses in the future. If the financial condition of the customers were to deteriorate, resulting in their inability to make payments, a larger allowance may be required.

Based on the above assessment, during the reporting years, the management establishes the general provision policy to make allowance equivalent to the sum of 3% of amount of account receivables less than 1 year, 15% of amount of account receivable between 1 year to 2 years, 40% of amount of account receivable between 2 years to 3 years and 100% of amount of account receivable above 3 years. Additional specific provision is made against account receivables to the extent which they are considered to be doubtful.

Bad debts are written off against allowance for doubtful accounts when identified. We do not accrue any interest on accounts receivable. Historically, losses from uncollectible accounts have not deviated from the general allowance estimated by the management and no bad debts have been written off against allowance for doubtful accounts directly to the profit and loss. This general provisioning policy has not changed in the past since establishment and the management considers that the aforementioned general provisioning policy is adequate and does not expect to change this established policy in the near future. Any changes on the estimates on our general provision policy could have a material effect on our results of operations.

#### Valuation of Long-Lived Assets

We assess the impairment of long-lived assets, which include goodwill, identifiable intangible assets, and property and equipment ("P&E"), at least annually for goodwill or whenever events or changes in circumstances indicate that the carrying value may not be recoverable for all long-lived assets. Changes in the underlying business could adversely affect the fair value of the enterprise and intangible asset and P&E asset groups. Important factors which could require an impairment review include: (i) underperformance relative to expected historical or projected future operating results; (ii) changes in the manner of use of the assets or the strategy for our overall business; (iii) negative industry or economic trends; (iv) our enterprise fair value relative to net book value.

Our impairment evaluation of identifiable intangible assets and P&E includes an analysis of estimated future undiscounted net cash flows expected to be generated by the assets over their remaining estimated useful lives. If the estimated future undiscounted net cash flows are insufficient to recover the carrying value of the assets over the remaining estimated useful lives, we record an impairment loss in the amount by which the carrying value of the assets exceeds the fair value. We determine fair value based on either market quotes, if available, or discounted cash flows using a discount rate commensurate with the risk inherent in our current business model for the specific asset being valued. Major factors that influence our cash flow analysis are our estimates for future revenue and expenses associated with the use of the asset. Different estimates could have a significant impact on the results of our evaluation. If, as a result of our analysis, we determine that our amortizable intangible assets or other long-lived assets have been impaired, we will recognize an impairment loss in the period in which the impairment is determined. Any such impairment charge could be significant and could have a material negative effect on our results of operations.

#### Share-based Compensation



We applied ASC 718, Compensation - Stock Compensation (formerly SFAS No. 123R, Share-Based Payment). ASC 718 requires that all share-based compensation be recognized as an expense in the consolidated financial statements and that such cost be measured at the fair value of the award and requires compensation cost to reflect estimated forfeitures. The determination of the fair value of share-based compensation awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including our expected stock price volatility over the term of the awards, actual and projected share option exercise behaviors, risk-free interest rate and expected dividends. The volatility of the Company's common stock was estimated by management based on the historical volatility of our common stock, the risk free interest rate was based on Treasury Constant Maturity Rates published by the U.S. Federal Reserve for periods applicable to the expected life of the

share option, the expected dividend yield was based on the Company's current and expected dividend policy, and the projected share option exercise behaviors is based on one-half of the sum of the vesting period and the contractual life of each share option. This is the same as assuming that the options are exercised at the mid-point between the vesting date and expiration date.

Any uncertainty associated with these assumptions may impact our consolidated financial statements might affect our valuation when the options are granted.

#### Inventories

Inventories are stated at the lower of cost or market, using the weighted average method. 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 inventory periodically to determine if any reserves are necessary for potential obsolescence.

#### 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.

#### 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.

#### 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 a 5% residual value.

#### Recently issued accounting pronouncements

In January 2010, FASB issued ASU No. 2010-01- "Accounting for Distributions to Shareholders with Components of Stock and Cash." The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – "Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification." The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are

included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – “Improving Disclosures about Fair Value Measurements.” This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances,

and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update 2010-09, "Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements," or ASU 2010-09. ASU 2010-09 primarily rescinds the requirement that, for listed companies, financial statements clearly disclose the date through which subsequent events have been evaluated. Subsequent events must still be evaluated through the date of financial statement issuance; however, the disclosure requirement has been removed to avoid conflicts with other SEC guidelines. ASU 2010-09 was effective immediately upon issuance and was adopted in February 2010.

In April 2010, the FASB issued Accounting Standards Update 2010-13, "Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades," or ASU 2010-13. This Update provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in currency of a market in which a substantial porting of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In April 2010, the FASB issued Accounting Standard Update 2010-17, "Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition" or ASU 2010-17. This Update provides guidance on the recognition of revenue under the milestone method, which allows a vendor to adopt an accounting policy to recognize all of the arrangement consideration that is contingent on the achievement of a substantive milestone (milestone consideration) in the period the milestone is achieved. The pronouncement is effective on a prospective basis for milestones achieved in fiscal years and interim periods within those years, beginning on or after June 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In July 2010, FASB issued Accounting Standard Update 2010-20, "Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" or ASU 2010-20. This Update provides enhanced disclosures which are designed to assist financial statement users in assessing an entity's credit risk exposure and in evaluating the adequacy of an entity's allowance for credit losses. Public entities must apply the disclosure requirements applicable to period-end balances beginning with the first interim or annual reporting period ending on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements

In September 2010, FASB issued Accounting Standard Update 2010-25, "Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans" or ASU 2010-25. The ASU clarifies how loans to participants should be classified and measured by defined contribution plans and how IFRS compare to these provisions. The amendments in this update are effective for fiscal years ending after December 15 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued Accounting Standard Update 2010-28, Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU modified Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. For public entities, the amendments in the ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued Accounting Standard Update 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. This ASU specifies that, if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU 2010-29 is effective prospectively for business combinations where the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

## Results of Operations

Comparison of the Years Ended December 31, 2010 and 2009:

|                             | 2010        |                    | For the Year Ended December 31, 2009 |                    | Y/Y Change  |        |
|-----------------------------|-------------|--------------------|--------------------------------------|--------------------|-------------|--------|
|                             | Amount (\$) | % of Total Revenue | Amount (\$)                          | % of Total Revenue | Amount (\$) | %      |
| Revenue                     |             |                    |                                      |                    |             |        |
| System contracting projects | 59,544,090  | 74.5 %             | 62,514,475                           | 77.0 %             | -2,970,385  | -4.8 % |
| Products                    | 16,834,582  | 21.0 %             | 15,718,815                           | 19.4 %             | 1,115,767   | 7.1 %  |
| Maintenance Services        | 3,598,010   | 4.5 %              | 2,947,908                            | 3.6 %              | 650,102     | 22.1 % |
| Total Revenue               | 79,976,682  | 100.0 %            | 81,181,198                           | 100.0 %            | -1,204,516  | -1.5 % |

Total revenues were approximately \$80.0 million for the year ended December 31, 2010 as compared to approximately \$81.2 million for the year ended December 31, 2009, a decrease of approximately \$1.2 million or 1.5%. This slight decrease in our total revenue was primarily due to the decrease in our revenues from system contracting projects, offset by the increase in our product sales and sales from our maintenance services during the period. The Company recognized revenues from 436 total solution, product sales and maintenance contracts for the year ended December 31, 2010 as compared to 445 contracts for the year ended December 31, 2009.

Revenues from our total solution system contracting projects decreased by 4.8% to \$59.5 million derived from 220 contracts for the year ended December 31, 2010, compared to \$62.5 million derived from 181 contracts for the year ended December 31, 2009. This decrease in revenues from our system contracting projects was mainly attributable to the slower progress in the projects from the iron and steel industry during period, as iron and steel industry has experienced significant weakness during recent quarters. Revenues from our product sales were \$16.8 million with 152 contracts executed for the year ended December 31, 2010, compared to \$15.7 million with 136 contracts executed for the year ended December 31, 2009. The increase in revenues from product sales was mainly due to the increase in value of product sales contracts executed in power generation industry during the period. Revenues from maintenance service increased by 22.1% to \$3.6 million derived from 64 contracts for the year ended December 31, 2010, compared to \$2.9 million derived from 128 contracts for the year ended December 31, 2009. The increase in revenues from maintenance service was mainly attributable to the increase in the number of maintenance service contracts executed as a result of the expansion of our customer base during the period.

In particular, our three largest clients were Wuhan Iron & Steel Group, Capital Iron & Steel Group (Caofeidian Project), Anshan Iron & Steel Group Chaoyang Company, which collectively contributed approximately \$40.2 million of revenues, representing 67.4% of total revenues for the year ended December 31, 2010.

Out of the system contracting revenue of \$59.5 million for the year ended December 31, 2010, iron and steel industry contributed the majority of revenues, approximately \$55.7 million or 93.3% of the revenue from system contracting

projects, while traditional power generation contributed approximately \$3.5 million or 5.9%. Petrochemical, nuclear and other verticals together represented the remaining \$0.48 million or 0.8% of revenue.

For the twelve months ended December 31, 2010, the significant increase in reliance on one client for the Company's operating results was due to the size of the total solution contract executed with Wuhan Iron and Steel. The value of this contract was approximately \$92 million, compared to the company's historical average of \$1 million for the iron and steel industry. Therefore, with the successful implementation of this project, for the twelve months ended December 31, 2010, Wuhan Iron and Steel contributed the largest portion of the Company's sales of any client. By the end of year 2010, the \$92 million contract with Wuhan Iron and Steel will only be 36.9%

complete; as a result, the Company expects that a large portion of its revenue in future reporting periods will rely on the execution of this contract.

|                             | 2010        |              | For the Year Ended December 31,<br>2009 |              | Y/Y Change  |         |
|-----------------------------|-------------|--------------|---|--------------|-------------|---------|
|                             | Amount (\$) | % of Revenue | Amount (\$)                             | % of Revenue | Amount (\$) | %       |
| <b>Cost of Revenues</b>     |             |              |   |              |             |         |
| System contracting projects | 28,897,445  | 48.5 %       | 26,769,508                              | 42.8 %       | 2,127,937   | 7.9 %   |
| Products                    | 7,342,962   | 43.6 %       | 5,589,310                               | 35.6 %       | 1,753,652   | 31.4 %  |
| Maintenance Services        | 2,457,833   | 68.3 %       | 1,769,104                               | 60.0 %       | 688,729     | 38.9 %  |
| Total Cost of Revenues      | 38,698,240  | 48.4 %       | 34,127,922                              | 42.0 %       | 4,570,318   | 13.4 %  |
| <b>Gross Profit</b>         |             |              |   |              |             |         |
| System contracting projects | 30,646,645  | 51.5 %       | 35,744,967                              | 57.2 %       | -5,098,322  | -14.3 % |
| Products                    | 9,491,620   | 56.4 %       | 10,129,505                              | 64.4 %       | -637,885    | -6.3 %  |
| Maintenance Services        | 1,140,177   | 31.7 %       | 1,178,804                               | 40.0 %       | -38,627     | -3.3 %  |
| Total Gross Profit          | 41,278,442  | 51.6 %       | 47,053,276                              | 58.0 %       | -5,774,834  | -12.3 % |

Cost of revenues for the year ended December 31, 2010 was approximately \$38.7 million, as compared to \$34.1 million for the year ended December 31, 2009, representing an increase of approximately \$4.6 million or 13.4%. The increase in our cost of revenues was mainly driven by the increase in our material costs and our subcontractor costs related to the execution of total solution and maintenance contracts, offset by the decrease in revenues from our system contracting projects during the period. Gross profit for the year ended December 31, 2010 was approximately \$41.3 million, as compared to \$47.1 million for the year ended December 31, 2009, a decrease of approximately \$5.8 million or 12.1%. Gross margin for the year ended December 31, 2010 was 51.6%, which is lower than the gross margin of 58.0% for the year ended December 31, 2009. The decrease in overall gross margin was mainly due to the decrease in the gross margin of system contracting projects and the gross margin of product sales during the period.

Gross margin of system contracting projects was 51.5% for the year ended December 31, 2010, compared to 57.2% for the year ended December 31, 2009. The decrease in gross margin of system contracting projects was mainly attributable to the contract mix during the period, as the gross margin of system contracting projects represents the average value of the gross margins of different system contracting projects executed in during the period. Since our gross margins during each quarter are determined by the revenue-weighted average of gross margins which are comprised of the gross margins of different system contracting projects executed during the period, the decrease in our gross margins of our system contracting projects was primarily due to the different contract mix during the twelve months ended December 31, 2010. In a given period, if more revenues are recognized from contracts with higher gross margins, this will result in a higher gross margin for the period. During the twelve months ended December 31, 2010, the iron and steel industry contributed higher percentage revenues as compared to the twelve months ended December 31, 2009. The increase in the percentage of revenue contribution from the iron and steel industry should have resulted in higher gross margins during the period. However during the twelve months ended December 31, 2010, the revenue-weighted average of gross margins from the iron and steel industry was only 54.8%, which was lower than the 60.0% for the same period of 2009. The decrease in average gross margin of total solution projects from the iron and steel industry outweighed the increase in the percentage of revenue contribution from the iron and steel industry, which led to a decrease in the overall gross margin of our system contracting projects during the period. We attributed the decrease in the average project gross margins from the iron and steel industry during the twelve months ended December 31, 2010 to the different contract mix during the period as the gross margin of individual



iron and steel contracts during certain period is determined by various factors including the complexity of project itself, competition during the bidding process as well as the variation in the project's gross margins due to the change from clients' requirement. However, from the aspect of overall iron and steel contracts, the gross margins of iron and steel contracts were maintained at similar levels to those of last year. Furthermore, we did not observe any trends or factors which could negatively impact gross margins from the iron and steel industry in the long run.

The gross margin of product sales was 56.4% for the year ended December 31, 2010, compared to 64.4% for the year ended December 31, 2009. The decrease in the gross margin of product sales was mainly attributable to a lower percentage of self-manufactured

proprietary products sold through our product sales contracts during the period, contributing to lower gross margin. Of the products sales in the year ended December 31, 2010, the percentage of self-manufactured proprietary products decreased to 37.8%, compared to 53.4% in fiscal year 2009. The main reason for the shift in sales from self-manufactured products to third-party manufactured products is the percentage of product sales from the petrochemical industry increased significantly to 26.7% in the twelve months ended December 31, 2010, compared to 6.9 % for the same period of last year. Since product sales contracts from the petrochemical industry typically use less self-manufactured proprietary products than those in other industries, the higher sales contribution from the petrochemical industry resulted into a lower percentage of self-manufactured proprietary products during the period. Gross margin of our maintenance services was 31.7% for the year ended December 31, 2010, compared to 40.0% for the year ended December 31, 2009. This decrease in the gross margin of our maintenance services was primarily due to the increase in our labor costs associated with the maintenance contracts during the period.

|                    | 2010        |                          | For the Year Ended December 31,<br>2009 |                          | Y/Y Change  |         |
|--------------------|-------------|--------------------------|---|--------------------------|-------------|---------|
|                    | Amount (\$) | % of<br>Total<br>Revenue | Amount (\$)                             | % of<br>Total<br>Revenue | Amount (\$) | %       |
| Operating Expenses |             |                          |   |                          |             |         |
| Selling Expense    | 10,135,884  | 12.7 %                   | 8,908,697                               | 11.0 %                   | 1,227,187   | 13.8 %  |
| General            |             |                          |   |                          |             |         |
| Administrative     | 10,822,596  | 13.5 %                   | 8,154,801                               | 10.0 %                   | 2,667,795   | 32.7 %  |
| Depreciation and   |             |                          |   |                          |             |         |
| Amortization       | 851,036     | 1.1 %                    | 773,907                                 | 1.0 %                    | 77,129      | 10.0 %  |
| R&D                | 1,966,557   | 2.5 %                    | 1,631,435                               | 2.0 %                    | 335,122     | 20.5 %  |
| Total              |             |                          |   |                          |             |         |
| Operating          |             |                          |   |                          |             |         |
| Expenses           | 23,776,073  | 29.7 %                   | 19,468,840                              | 24.0 %                   | 4,307,233   | 22.1 %  |
| Income From        |             |                          |   |                          |             |         |
| Operations         | 17,502,369  | 21.9 %                   | 27,584,436                              | 34.0 %                   | -10,082,067 | -36.5 % |

Operating expenses were approximately \$23.8 million for the year ended December 31, 2010 as compared to approximately \$19.5 million for the year ended December 31, 2009, an increase of approximately \$4.3 million or 22.1%. This increase in operating expenses was mainly attributable to the slight increase in selling, general administrative and R&D expenses during the period.

Selling expenses were approximately \$10.1 million for the year ended December 31, 2010 as compared to approximately \$8.9 million for the year ended December 31, 2009, an increase of approximately \$1.2 million or 13.8%. The increase in selling expenses was mainly attributable to the increase in sales-related activities in the iron and steel, power generation and chemical industries and efforts to expand into new industries including nuclear power, transportation and international markets. General administrative expenses were approximately \$10.8 million for the year ended December 31, 2010, as compared to approximately \$8.2 million for the year ended December 31, 2009, an increase of approximately \$2.7 million or 32.7%. The significant increase in general administrative expenses was mainly attributable to increases in the number of total employees, every employee salary and the compensation related to the issued options and restricted stocks during the period. Depreciation and amortization expenses were approximately \$0.9 million for the year ended December 31, 2010 as compared to approximately \$0.8 million for the year ended December 31, 2009, an increase of \$77,129 or 10.0%. The slight increase in depreciation and amortization expenses was mainly due to the increase in our plant and equipment related to business operations. R&D expenses were approximately \$2.0 million for the year ended December 31, 2010 as compared to approximately \$1.6 million for the year ended December 31, 2009, an increase of approximately \$0.3 million or 20.5%. The increase in R&D expenses was mainly attributable to the variance in expenditures required in different new product development

cycles.

Operating income was approximately \$17.5 million for the year ended December 31, 2010 as compared to approximately \$27.6 million for the year ended December 31, 2009, a decrease of approximately \$10.1 million or -36.5%. The decrease in our operating income was mainly attributable to the decrease in revenues and lower gross margins during this period.

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Total other income was approximately \$1.1 million for the year ended December 31, 2010 as compared to approximately \$0.9 million for the year ended December 31, 2009, an increase of \$119,912 million or 12.7%.

Income before income tax was approximately \$18.6 million for the year ended December 31, 2010 as compared to approximately \$28.5 million for the year ended December 31, 2009, a decrease of \$10.0 million or -34.9%. The reason for the decrease in income before income tax was mainly due to the decrease in revenues and operating margin during the period. Provision for income tax was approximately \$3.2 million for the year ended December 31, 2010 with an effective tax rate of approximately 17.3%, as compared to a \$4.2 million provision for income tax for the year ended 31, December 2009, a decrease of \$0.9 million. The decrease in provision for income tax was mainly due to a decrease in income before income tax during the period.

Our net income was approximately \$15.4 million for the year ended December 31, 2010 as compared to approximately \$24.3 million net income for the year ended December 31, 2009, a decrease of \$9.0 million or -36.8%. The reason for this decrease in net income was mainly due to the decrease in revenue as well as decrease in gross margin during the period.

Currency translation adjustments resulting from RMB appreciation amounted to \$4.0 million and \$19,093 for the years ended December 31, 2010 and 2009, respectively.

The comprehensive income, which adds the currency adjustment to the net income, was approximately \$19.5 million for the year ended December 31, 2010 as compared to approximately \$24.4 million comprehensive income for the year ended December 31, 2009, a decrease of \$5.0 million or 20.3%.

Comparison of the Years Ended December 31, 2009 and 2008:

|                             | For the Year Ended December 31, |                    |             |                    |             |       |
|-----------------------------|---------------------------------|--------------------|-------------|--------------------|-------------|-------|
|                             | 2009                            |                    | 2008        |                    | Y/Y Change  |       |
|                             | Amount (\$)                     | % of Total Revenue | Amount (\$) | % of Total Revenue | Amount (\$) | %     |
| Revenue                     |                                 |                    |             |                    |             |       |
| System contracting projects | 62,514,475                      | 77.0%              | 57,101,984  | 82.7%              | 5,412,491   | 9.5%  |
| Products                    | 15,718,815                      | 19.4%              | 9,673,922   | 14.0%              | 6,044,893   | 62.5% |
| Maintenance Services        | 2,947,908                       | 3.6%               | 2,303,213   | 3.3%               | 644,695     | 28.0% |
| Total Revenue               | 81,181,198                      | 100.0%             | 69,079,119  | 100.0%             | 12,102,079  | 17.5% |

Total revenues were approximately \$81.2 million for the year ended December 31, 2009 as compared to approximately \$69.1 million for the year ended December 31, 2008, an increase of approximately \$12.1 million or 17.5%. This increase was primarily due to the increase in revenues from product sales and maintenance services during the period. The Company recognized revenues from 445 total solution, product sales and maintenance contracts for the year ended December 31, 2009 as compared to 319 contracts for the year ended December 31, 2008.

Revenues from total solution system contracting projects increased by 9.5% to \$62.5 million derived from 181 contracts for the year ended December 31, 2009, compared to \$57.1 million derived from 161 contracts for the year ended December 31, 2008. This increase in revenues from system contracting projects was mainly attributable to the increase in the number of system contracting projects we executed and the successful execution of large-size projects such as the Caoheidian Project of Capital Iron and Steel Group during the fiscal year. Revenues from product sales were \$15.7 million with 136 contracts executed for the year ended December 31, 2009, compared to \$9.7 million with 115 contracts executed for the year ended December 31, 2008. The increase in revenues from product sales was mainly due to the increase in value of product sales contracts executed in the power generation industry. Revenues

from maintenance service increased by 28.0% to \$2.9 million derived from 128 contracts for the year ended December 31, 2009, compared to \$2.3 million derived from 43 contracts for the year ended December 31, 2008. The increase in revenues from maintenance service was mainly attributable to the increase in the number of maintenance service contracts executed as the result of the expansion of our customer base during the period.

In particular, our three largest clients were Capital Iron and Steel Group, Jiannan Iron and Steel Group and Capital Engineering & Research Inc., which collectively contributed approximately \$18.9 million of revenues, representing 23.2% of total revenues for the year ended December 31, 2009.

Out of the system contracting revenue of \$62.5 million for the year ended December 31, 2009, iron and steel industry was the major industry, contributing approximately \$53.9 million or approximately 86.3% of the revenue from system contracting projects, while traditional power generation contributed approximately \$6.7 million or approximately 10.6%. Petrochemical, nuclear and other verticals together represented the remaining \$1.9 million or 3.1% of revenue.

For the year ended December 31, 2009, the significant increase in reliance on one client for the Company's operating results was due to the size of the total solution contract executed with Capital Iron and Steel Group. The value of this contract was approximately \$31 million, compared to the company's historical average of \$1 million for the iron and steel industry. Therefore, with the successful implementation of this project, for the year ended December 31, 2009, Capital Iron and Steel Group contributed the largest portion of the Company's sales of any client. By the end of year 2009, the \$31 million contract with Capital Iron and Steel Group will only be 80.2% complete; as a result, the Company expects that a large portion of its revenue in future reporting periods will rely on the execution of this contract.

|                             | For the Year Ended December 31, |              |             |              |             |        |
|-----------------------------|---------------------------------|--------------|-------------|--------------|-------------|--------|
|                             | 2009                            |              | 2008        |              | Y/Y Change  |        |
|                             | Amount (\$)                     | % of Revenue | Amount (\$) | % of Revenue | Amount (\$) | %      |
| <b>Cost of Revenues</b>     |                                 |              |             |              |             |        |
| System contracting projects | 26,769,508                      | 42.8%        | 25,805,086  | 45.2%        | 964,422     | 3.7%   |
| Products                    | 5,589,310                       | 35.6%        | 2,558,844   | 26.5%        | 3,030,466   | 118.4% |
| Maintenance Services        | 1,769,104                       | 60.0%        | 1,217,316   | 52.9%        | 551,788     | 45.3%  |
| Total Cost of Revenues      | 34,127,922                      | 42.1%        | 29,581,246  | 42.8%        | 4,546,676   | 15.4%  |
| <b>Gross Profit</b>         |                                 |              |             |              |             |        |
| System contracting projects | 35,744,967                      | 57.2%        | 31,296,898  | 54.8%        | 4,448,069   | 14.2%  |
| Products                    | 10,129,505                      | 64.4%        | 7,115,078   | 73.5%        | 3,014,427   | 42.4%  |
| Maintenance Services        | 1,178,804                       | 40.0%        | 1,085,897   | 47.1%        | 92,907      | 8.6%   |
| Total Gross Profit          | 47,053,276                      | 58.0%        | 39,497,873  | 57.2%        | 7,555,403   | 19.1%  |

Cost of revenues for the year ended December 31, 2009 was approximately \$34.1 million, as compared to \$29.6 million for the year ended December 31, 2008, representing an increase of approximately \$4.5 million or 15.4%. The increase in cost of revenues was mainly driven by the increase in revenue as well as the increase in subcontractor cost while we executed total solution and maintenance contracts during the period. Gross profit for the year ended December 31, 2009 was approximately \$47.1 million, as compared to \$39.5 million for the year ended December 31, 2008, an increase of approximately \$7.6 million or 18.7%. Gross margin for the year ended December 31, 2009 was 58.0%, which is slightly higher than the gross margin of 57.2% for the year ended December 31, 2008. The increase in gross margin was mainly due to the increase in the gross margin of system contracting projects, offset by a decrease in the gross margin of product sales and maintenance services during the period.

Gross margin of system contracting was 57.2% for the year ended December 31, 2009, compared to 54.8% for the year ended December 31, 2008. This increase in the gross margin of system contracting projects was due to the successful execution of total solution contracts in the iron and steel industry that contributed higher gross margins during the fiscal year. Total solution projects from the iron and steel industry contributed higher gross margins than the projects from other industries due to a higher percentage of our self-manufactured proprietary products being

utilized in the iron and steel projects, partially offset by the increase in our subcontractor cost. The gross margin of product sales was 64.4% for the year ended December 31, 2009, compared to 73.5% for the year ended December 31, 2008. The decrease in the gross margin of product sales was mainly attributable to a lower percentage of self-manufactured proprietary products sold through product sales contracts during the period, contributing to lower gross margin. Gross margin of maintenance services was 40.0% for the year ended December 31, 2009, compared to 47.1% for the year ended December 31, 2008. This decrease in the gross margin of maintenance services was primarily due to the increase in associated labor costs during the period. Out of product sales of \$15.7 million during the year 2009, 52% related to self-manufactured proprietary products, and 48% related to third party products.

In 2009, the iron and steel industry was the Company's largest vertical contributing approximately 75% of revenue. Based on the Company's strategy, we are working towards further expanding our business into other verticals including conventional power plants, power transmission (grid), nuclear power plants, petroleum and natural gas, petrochemical, transportation (subways, highway tunnels, high speed trains), ships and marine, telecommunications carriers. We believe that the introduction of new products and entry into new verticals may positively impact our revenue, but in the meantime negatively impacted our gross margins. The reason for the lower gross margins in other industries is a lower percentage of self-manufactured proprietary products would be used in other industries than in the iron and steel industry, since the products required in the total solutions by the fire codes for the iron and steel are our self-manufactured high-end products which are associated with and protected by the Company's intellectual properties. Because the fire codes for other industries in China are not as strict as the fire codes in the iron and steel industry, more third-party manufactured were used than that in iron and steel industry.

|                               | For the Year Ended December 31, |                    |             |                    |             |        |
|-------------------------------|---------------------------------|--------------------|-------------|--------------------|-------------|--------|
|                               | 2009                            |                    | 2008        |                    | Y/Y Change  |        |
|                               | Amount (\$)                     | % of Total Revenue | Amount (\$) | % of Total Revenue | Amount (\$) | %      |
| Operating Expenses            |                                 |                    |             |                    |             |        |
| Selling Expense               | 8,908,697                       | 11.0%              | 6,434,887   | 9.3%               | 2,473,810   | 38.4%  |
| General Administrative        | 8,154,801                       | 10.0%              | 6,680,992   | 9.7%               | 1,473,809   | 22.1%  |
| Depreciation and Amortization | 773,907                         | 1.0%               | 712,269     | 1.0%               | 61,638      | 8.7%   |
| R&D                           | 1,631,435                       | 2.0%               | 2,102,976   | 3.0%               | (471,541)   | -22.4% |
| Total Operating Expenses      | 19,468,840                      | 24.0%              | 15,931,124  | 23.1%              | 3,537,716   | 22.2%  |
| Income From Operations        | 27,584,436                      | 34.0%              | 23,566,749  | 34.1%              | 4,017,687   | 17.0%  |

Operating expenses were approximately \$19.5 million for the year ended December 31, 2009 as compared to approximately \$15.9 million for the year ended December 31, 2008, an increase of approximately \$3.5 million or 22.2%. The increase in operating expenses was mainly due to the increase in selling and general administrative expense, offset by the decrease in R&D expenditure during the fiscal year.

Selling expenses were approximately \$8.9 million for the year ended December 31, 2009 as compared to approximately \$6.4 million for the year ended December 31, 2008, an increase of approximately \$2.5 million or 38.4%. The significant increase in selling expenses was mainly attributable to the increase in marketing activities and efforts to expand our business into new markets including the retrofitting market in the iron and steel industry. General administrative expenses were approximately \$8.2 million for the year ended December 31, 2009, as compared to approximately \$6.7 million for the year ended December 31, 2008, an increase of approximately \$1.5 million or 22.1%. The increase in general administrative expenses was mainly attributable to the increase in employees' salaries and compensation and the increase in bad debt expenses during the period. Depreciation and amortization expenses were approximately \$0.8 million for the year ended December 31, 2009 as compared to approximately \$0.7 million for the year ended December 31, 2008, an increase of \$61,638 or 8.7%. The slight increase in depreciation and amortization expenses was mainly due to the increase in plant and equipment related to business operations. R&D expenses were approximately \$1.6 million for the year ended December 31, 2009 as compared to approximately \$2.1 million for the year ended December 31, 2008, a decrease of approximately \$0.5 million or 22.4%. The decrease in R&D expenses was mainly attributable to the variance in expenditures required in different product development cycles.

Operating income was approximately \$27.6 million for the year ended December 31, 2009 as compared to approximately \$23.6 million for the year ended December 31, 2008, an increase of approximately \$4.0 million or 17.0%. The increase in operating income was mainly attributable to the increase in revenues and higher gross margins during this period.



Total other income was approximately \$0.9 million for the year ended December 31, 2009 as compared to approximately \$1.2 million for the year ended December 31, 2008, a decrease of \$0.3 million or 20.6%.

Income before income tax was approximately \$28.5 million for the year ended December 31, 2009 as compared to approximately \$24.8 million for the year ended December 31, 2008, an increase of \$3.8 million or 15.2%. The reason for this increase in income before income tax was mainly due to the increase in revenues offset by the decrease in operating margin during the period. Provision for income tax was approximately \$4.2 million for the year ended December 31, 2009 with an effective tax rate of approximately 14.6%, as compared to \$47,423 provision for income tax for the year ended 31, December 2008, an increase of \$4.2 million. The

significant increase in provision for income tax was mainly due to the fact that Sureland Industrial, our major operating subsidiary, began to pay income tax at a rate of 12.5% with 50% tax exemption, after the expiration of its 100% tax exemption period in 2008.

Net income was approximately \$24.4 million for the year ended December 31, 2009 as compared to approximately \$24.7 million net income for the year ended December 31, 2008, a decrease of \$0.3 million or 1.2%. The reason for this slight decrease in net income was mainly due to the significant increase in the provision of income tax, offset by the increase in income before income tax during the period.

Currency translation adjustments resulting from RMB appreciation amounted to \$19,093 and \$3,737,027 for the years ended December 31, 2009 and 2008, respectively.

The comprehensive income, which adds the currency adjustment to the net income, was approximately \$24.4 million for the year ended December 31, 2009 as compared to approximately \$28.4 million comprehensive income for the year ended December 31, 2008, a decrease of \$4.0 million or 14.1%.

### Liquidity and Capital Resources

As of December 31, 2010, we had working capital of \$106.5 million, including cash and cash equivalents of \$28.1 million. The following table sets forth a summary of our cash flow for the periods indicated:

#### Statements of Cash Flow

|   | Year Ended December 31 |              |               |
|---|------------------------|--------------|---------------|
|   | 2010                   | 2009         | 2008          |
| Net cash provided by (used in) operating activities                 | \$ (2,190,269)         | \$ 5,467,756 | \$ 13,361,704 |
| Net cash provided by (used in) investing activities                 | (1,582,860)            | 948,283      | (1,945,199)   |
| Net cash provided by (used in) financing activities                 | (3,695,888)            | 1,897,613    | (3,097,855)   |
| Effect of foreign currency translation on cash and cash equivalents | 643,826                | 7,895        | 1,226,234     |
| Net cash flow   | \$ (6,825,191)         | \$ 8,321,547 | 9,544,884     |

### Operating Activities

#### Comparison of the Years Ended December 31, 2010 and 2009

Net cash used by operating activities was approximately \$2.2 million for the year ended December 31, 2010 as compared to approximately \$5.5 million provided for the same period in 2009. The decrease in net cash provided by operating activities was mainly due to the slower cash payments collected from our customers during the weakness experienced in the iron and steel industry in 2010. Net cash provided by operating activities in the year ended December 31, 2010 was mainly due to net income of \$15.4 million, a \$4.7 million increase in accrued liabilities and \$1.4 million increase in billings in excess of costs and estimated earnings, offset by a \$9.7 million increase in notes receivable, 10.2 million increase in accounts receivable, an \$2.8 million increase in costs and estimated earnings in excess of billing, a \$6.5 million decrease in prepayment and deferred expenses.

The increase of \$2.8 million in costs and estimated earnings in excess of billings in 2010 was mainly due to the increase in aggregate value of projects where we have recognized revenues more than we have billed our customers for these projects, while the decrease in billings in excess of costs and estimated earnings was mainly due to the decrease in aggregate value of projects where we have billed our customers less than we have recognized revenues for

these projects.

As of December 31, 2010, approximately 7.2% of accounts receivable related to revenue recognized for maintenance service contracts and were due from clients in China's iron and steel industry. Most of these clients are leading, large-size State-Owned Enterprises ("SOEs"), and include Anshan Iron and Steel, Wuhan Iron and Steel and Capital Iron and Steel. Since China's government is the majority shareholder of these companies, the creditworthiness of these companies is generally perceived to be much higher than that of private companies in the market. Moreover, we have not observed nor do we expect to observe any bankruptcies amongst these leading SOEs in the foreseeable future. Therefore, we believe that the accounts receivable for maintenance service contracts are highly

collectible. Also, given that accounts receivable from such SOEs are overall highly collectible, it is customary in the interest of maintaining client relationships and securing recurring maintenance contracts not to aggressively enforce the collection of receivables.

During the past year, we did not change or extend our standard contract payment terms. Primarily, fundamental weaknesses in the iron and steel industry resulted in the delay of customers' payments related to the revenue recognized for maintenance service contracts beyond one-year. These delays also are a side effect of the industry practice to not aggressively enforce collection of SOE receivables in the interest of maintaining client relationships. These late payments were the result of our goodwill to maintain client relationships rather than the result of payment extensions.

According to our standard contract terms, the prerequisite that must be met in order to have the legal right to bill our customers for the amounts recognized as unbilled costs and earnings is the customer's acceptance of the completion of different stages throughout the implementation of the whole project. This is accomplished through the customer's inspection process upon completion of certain stages of a project's implementation including (but not limited to): the completion of a project's design, the delivery of certain equipment to a project's location, the completion of a certain stage of a project's construction, the completion of a system adjustment and final acceptance by the customer and the fire safety department. For a standard system contracting project, there are multiple stages of construction, customer inspection and billing. These processes are on-going throughout the term of the contract, which can be for an extended period of time. In our operating history, we have never been unable to bill our customers or receive payments for the amounts recognized as unbilled costs and earnings as a result of the customer's inspection process upon achieving a certain stage. Therefore, the collectability of the amounts recognized as unbilled costs and earnings is reasonably assured.

The main reason for the recent delays or prolonged customer inspection processes is the weakness in the iron and steel industry. These delays or prolonged inspection processes can slow the customers' payments to their suppliers including our company. The recent delays in our customer's inspection process did not relate to any performance issues raised by our customers. We have not experienced any inability to bill and/or non-payment for a receivable and/or customer's claim because of a contract dispute. In recent quarters, we have not made any material changes in the standard contract payment provisions as compared to prior periods. In the future, we will disclose any material contract changes to our standard contractual terms and also provide investors with an explanation of such changes, along with an explanation of any material impact such changes are having or may have on our operating results and liquidity.

There are a number of factors and/or circumstances that could adversely impact our ability to collect the receivables from and/or bill the Costs and estimated earnings in excess billings ("CIEB") to the SOEs. First, a significant decline in the overall demand for iron and steel products in China could adversely impact our ability to collect the receivables from and/or bill the CIEB to the SOEs. The iron and steel industry is one of the core industries in China's economy. Thus, the Chinese government has a vested interest in maintaining the health of this sector and consequently maintains shareholdings in key players in the industry. However, if there was a significant decrease in the overall demand for iron and steel products in China, the Chinese government could be forced to close certain companies, even SOEs, whose iron and steel production capacities are outdated. Second prolonged monetary losses amongst SOEs could adversely impact our ability to collect the receivables from and/or bill the CIEB to the SOEs. If the iron and steel SOEs sustained long-term losses with no prospects for improvement, there exists the possibility that the Chinese government could force these SOEs to be acquired or even shutdown. Even though the possibility exists, we have never observed these circumstances nor do we expect them to occur in the foreseeable future.

As the Chinese government is only a shareholder in these SOEs, we do not have any direct recourse against the Chinese government and there is not any requirement for the Chinese government to settle and/or act on the payment of the receivables.

However, there are a few mechanisms available to us to collect the receivables from the SOEs, including the following:

- 1) In order to improve the collection of our accounts receivable, during the third quarter we formed a special accounts receivable collection team to enhance communication with our clients. Not only do we assign accounts receivable quotas to each individual sales person, we also hold a weekly accounts receivable team call to ensure full execution and effectiveness of our accounts receivable collection process.
- 2) If the enhanced collection effort does not lead to a successful collection of receivables, we can have our counsel send an opinion letter to our delinquent clients to express our serious concern over the collection of the outstanding receivables and highlighting the importance we attach to the collection of receivables.

3) If the two mechanisms discussed above do not produce positive results in the collection of our receivables, the last mechanism available to us is to initiate a legal proceeding in a Chinese court against any clients unwilling to pay us. However, it is difficult to predict how long a lawsuit can take or its final adjudication. In the history of the Company's operation, we have never initiated a legal proceeding against our SOE clients over payment matters.

Account Receivable Aging Analysis, as of December 31, 2010

|         | 1-180 days | 181-360 days | 361-720 days | 720-1080 days | over 1080 days | Total      |
|---------|------------|--------------|--------------|---------------|----------------|------------|
| Balance | 25,991,333 | 6,547,924    | 11,195,429   | 5,031,048     | 4,073,614      | 52,839,348 |

As of December 31, 2010, the Company believes that there was 14.7 percentage of accounts receivable would be collected in more than one year, based on our historical collection pattern

CIEB is the net difference between the aggregate values of recognized revenue versus the aggregate value of invoices billed. This account reflects the timing difference between the date that we recognize revenue and the date that we bill to our customers. Revenue recognized from total solution projects is based on the percentage of project's completion, which most properly reflects the progress of total solution service we render to our clients, while the billing to our customers was based on the contract's payment schedule of our clients.

As of December 31, 2010, the balance of CIEB was \$40.7 million. There was a material portion of CIEB was not yet billed in the early of March, 2011. The reason for the increase in CIEB in recent quarters is mainly due to the clients' prolonged inspection and approval period for the project completion in their administrative process, as China's iron and steel industry experienced industry-wide weakness during recent quarters. However, we believe that this industry-wide weakness is short-term. The ratio of CIEB relative to our total current will revert back to historical level when the iron and steel industry recovers.

Comparison of the Years Ended December 31, 2009 and 2008

Net cash provided by operating activities was approximately \$5.5 million for the year ended December 31, 2009 as compared to approximately \$13.4 million for the same period in 2008. The decrease in net cash provided by operating activities was mainly due to the slower cash payments collected from our customers during the global financial crisis experienced in 2009. Net cash provided by operating activities in the year ended December 31, 2009 was mainly due to net income of \$24.4 million, a \$6.7 million increase in accrued liabilities and a \$6.9 million increase in taxes payable, offset by a \$9.9 million increase in accounts receivable, an \$18.7 million increase in costs and estimated earnings in excess of billing, a \$3.9 million decrease in customer deposits and a \$2.8 million decrease in billings in excess of costs and estimated earnings. The increase in accrued liabilities, accounts receivable and cost and estimated earnings in excess of billing was mainly attributable to the growth of our business during the fiscal year.

The increase of \$18.7 million in costs and estimated earnings in excess of billings in 2009 was mainly due to the increase in aggregate value of projects where we have recognized revenues more than we have billed our customers for these projects, while the decrease in billings in excess of costs and estimated earnings was mainly due to the decrease in aggregate value of projects where we have billed our customers less than we have recognized revenues for these projects.

Investing Activities

Comparison of the Years Ended December 31, 2010 and 2009

Net cash used by investing activities in the year ended December 31, 2010 was \$1.6 million as compared to net cash provided in investing activities of \$0.9 million in the year ended December 31, 2009. The cash used by investing

activities in the year ended December 31, 2010 was mainly attributable to capital expenditure in the purchase of new equipment and the improvement of office and manufacturing facilities.

Comparison of the Years Ended December 31, 2009 and 2008

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Net cash provided by investing activities in the year ended December 31, 2009 was \$0.9 million as compared to net cash used in investing activities of \$1.9 million in the year ended December 31, 2008. The cash provided by investing activities in the year ended December 31, 2009 was mainly attributable to proceeds received from the sales of our investments, offset by capital expenditure in the purchase of new equipments and the improvement of office and manufacturing facilities.

Net cash provided by investing activities in 2009 was mainly attributable to the proceeds of \$1.6 million received from the restructuring of Tianxiao Fire Safety Equipment Co. Ltd. and the proceeds of \$1.0 million received from the sales of our investment in King Galaxy Investments Ltd., offset by the capital expenditure of \$1.3 million to purchase building and equipment in 2009.

#### Financing Activities

##### Comparison of the Years Ended December 31, 2010 and 2009

Net cash used by financing activities in the year ended December 31, 2010 totaled \$3.7 million as compared to \$1.9 million provided by financing activities in the year ended December 31, 2009. The cash used by financing activities in the year ended December 31, 2010 was mainly attributable to the increase in restricted cash during the period.

##### Comparison of the Years Ended December 31, 2009 and 2008

Net cash provided by financing activities in the year ended December 31, 2009 totaled \$1.9 million as compared to \$3.1 million used by financing activities in the year ended December 31, 2008. The cash provided by financing activities in the year ended December 31, 2009 was mainly attributable to the decrease in restricted cash during the period.

#### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our investors.

#### Contractual Obligations

We do not have contractual obligations as of December 31, 2010.

#### Item 7A. Quantitative And Qualitative Disclosures About Market Risk

Market risk is the risk of loss to future earnings, to fair values or to future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, exchange rates, commodity prices, equity prices and other market changes. Cash and cash equivalents are held for working capital purposes and consist primarily of bank deposits. We do not enter into investments for trading or speculative purposes.

#### Interest Rate Risk

We currently do not have any long-term debt. Exposure to interest rate risk primarily relates to the interest income generated by excess cash invested in demand deposits. We have not used derivative financial instruments in our investment portfolio in order to reduce interest rate risk. Interest earning instruments carry a degree of interest rate risk and our future interest income may change, depending on market interest rate movement.



### Foreign Currency Risk

Our business is operated in the PRC and India, and its value is effectively denominated in Renminbi and Indian Rupees. The fluctuation of foreign exchange rate between U.S. dollars and Renminbi and U.S. Dollars and Indian Rupees could affect the value of our Common Stock. Our revenues and expenses are primarily denominated in Renminbi and Indian Rupees, so our exposure to foreign exchange risks to Renminbi should generally be limited. In 2009, we began to develop our business in India; revenues and expenses of our operations there are denominated in India's Rupee. However the revenue contribution from our operations in India is immaterial to our overall business in 2010. Thus, we believe that our exposure to foreign exchange risks to the Indian Rupee should generally be limited.

We do not have material monetary assets and liabilities denominated in U.S. dollars, although to the extent that we do in the future, the fluctuation of foreign exchange rate would affect the value of these monetary assets and liabilities denominated in U.S. dollars. Generally, appreciation of the Renminbi against U.S. dollars will devalue the assets and liabilities denominated in U.S. dollar, while devaluation of Renminbi and the Indian Rupee against the U.S. dollar will appreciate the assets and liabilities denominated in U.S. dollars. In China and India, very limited hedging transactions are available to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure.

#### Item 8. Financial Statements And Supplementary Data

- (a) Financial statements required by Item 8 are set forth at the pages indicated in item 15(a) below.  
 (b) Supplementary Data:

#### QUARTERLY DATA (UNAUDITED)

| 2009   | Years Ended December 31 |                |               |                |            |
|--|-------------------------|----------------|---------------|----------------|------------|
|  | First Quarter           | Second Quarter | Third Quarter | Fourth Quarter | Full Year  |
| Revenues   | 16,712,211              | 22,731,868     | 24,816,429    | 16,920,690     | 81,181,198 |
| Gross profits  | 10,296,759              | 14,500,571     | 13,999,311    | 8,256,635      | 47,053,276 |
| Net income<br>Attributable to<br>Controlling<br>Interest | 5,645,603               | 8,336,222      | 7,553,941     | 2,879,070      | 24,414,836 |
| Earnings per<br>share                                    | \$ 0.20                 | \$ 0.30        | \$ 0.27       | \$ 0.11        | \$ 0.88    |
| Earnings per<br>share Diluted                            | \$ 0.20                 | \$ 0.29        | \$ 0.27       | \$ 0.10        | \$ 0.86    |

| 2010   | Years Ended December 31 |                |               |                |            |
|--|-------------------------|----------------|---------------|----------------|------------|
|  | First Quarter           | Second Quarter | Third Quarter | Fourth Quarter | Full Year  |
| Revenues   | 20,943,726              | 22,833,431     | 24,817,588    | 11,381,937     | 79,976,682 |
| Gross profits  | 11,632,156              | 12,395,052     | 12,541,575    | 4,709,659      | 41,278,442 |
| Net income<br>Attributable to<br>Controlling<br>Interest | 5,247,225               | 6,333,660      | 5,934,770     | (2,077,720)    | 15,437,935 |
| Earnings per<br>share                                    | \$ 0.19                 | \$ 0.23        | \$ 0.22       | \$ (0.08)      | \$ 0.56    |
| Earnings per<br>share Diluted                            | \$ 0.19                 | \$ 0.22        | \$ 0.20       | \$ (0.07)      | \$ 0.52    |

#### Item 9. Changes In and Disagreements With Accountants On Accounting and Financial Disclosure

Not applicable.

#### Item 9A. Controls And Procedures



(a) Management's annual report on disclosure control and procedures.

As required by Exchange Act Rule 13a-15(b), our management has carried out an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2010.

Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2010.

(b) Management's annual report on internal control over financial reporting.

As required by Exchange Act Rule 13a-15(c), our management has carried out an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our internal control over financial reporting as of December 31, 2010.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the Company,

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the board of directors of the Company, and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2010. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on our assessment, we determined that, as of December 31, 2010, our internal control over financial reporting was effective. Frazer Frost, LLP, an independent registered public accounting firm, has audited the financial statements included in this annual report and, as part of the audit, has issued a report, included herein, on the effectiveness of our internal control over financial reporting as of December 31, 2010.

(c) Changes in Internal Controls over Financial Reporting

During the fourth fiscal quarter ended December 31, 2010, there was no change in our internal controls over financial reporting that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

(d) Independent Registered Public Accounting Firm's Attestation Report

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited China Fire & Security Group, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). China Fire & Security Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management's Annual Report on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, China Fire & Security Group, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and the related consolidated statements of income and other comprehensive income, changes in equity, and cash flows of China Fire & Security Group, Inc. and subsidiaries, and our report dated March 16, 2011 expressed an unqualified opinion.

/s/ Frazer Frost, LLP

Brea, California  
March 16, 2011

Item 9B. Other Information

None.

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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. Our executive officers and directors as of March 15, 2011 are listed below. The ages shown are as of March 15, 2011.

| Name             | Age | Position  |
|------------------|-----|---|
| Weigang Li       | 43  | Chairman of the Board                             |
| Brian Lin        | 46  | Director and Chief Executive Officer              |
| Tongzhou Qin     | 41  | Chief Financial Officer                           |
| Weishe Zhang     | 46  | Director and Vice President of Strategic Planning |
| Xiaoyuan Yuan    | 36  | Principal Accounting Officer                      |
| Xianghua Li      | 66  | Independent Director                              |
| Yinqing Li       | 58  | Independent Director                              |
| Guoyou Zhang     | 59  | Independent Director                              |
| Albert McLelland | 52  | Independent Director                              |

Mr. Weigang Li, Chairman of the Board, Vice President of Sales of China Fire, General Manager of Sureland Industrial, 43. 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. Brian Lin, Chief Executive Officer, Director, 46. Since March 2010, Mr. Lin serves as our Chief Executive Officer. From December 2009 through March 2010, Mr. Lin served as our Chief Financial Officer. Mr. Lin has served as a director since October 2006 and served as our Chief Executive Officer from October 2006 to December 2009. Mr. Lin has over 17 years of management and technical experience both in the United States 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 from 2001 to 2005. Mr. Lin received his Master's Degree in Electrical Engineering from University of Toronto, Canada in 1989. We believe Mr. Lin's qualifications to serve on our board include his extensive knowledge of the Company as a long-term executive, which gives him detailed understanding of the complexities of our operations.

Mr. Tongzhou Qin, Chief Financial Officer, Deputy General Manager of Sureland Industrial, 41. Mr. Qin joined the Company in March 2010 as the Deputy General Manager of Sureland Industrial, one of the Company's indirect subsidiaries, responsible for finance, internal audit, human resources and administration. Mr. Qin has over 18 years of accounting, finance and general management experience. Prior to joining the Company, he was the senior manager at Ernst & Young Huaming Certified Public Accounting Firm in Beijing from March 2001 to February 2010, where he led the audit team and advised clients on internal controls, corporate governance and other public listing rules. Mr.



Qin is a Certified Public Accountant, Certified Public Valuer and Certified Tax Agent in the PRC. Mr. Qin obtained his Bachelors degree in Investment Economy Management from China's Central University of Finance and Economy in 1992.

Mr. Weishe Zhang, Vice President, Director, 46. Since December 2009, Mr. Zhang has served as Vice President of strategic planning and management of marketing, technology and product development. Mr. Zhang has served as a director since February 2009 and served as Chief Technology Officer from February 2009 to December 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. We believe Mr. Zhang's qualifications to serve on our board include his extensive knowledge of the Company and his extensive knowledge and experience of the markets in which we conduct business. Furthermore, Mr. Zhang is a professional in the technology that we utilize and provides technical support to the board, which support is particularly important when evaluating new ventures proposed to the board.

Mr. Xiaoyuan (Robert) Yuan, Principal Accounting Officer, 36. Mr. Xiaoyuan (Robert) Yuan joined the Company as Chief Accounting Officer 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 an MBA with a concentration in finance in 2003.

Mr. Xianghua Li, Director, 66. 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 received his diploma from the Military School of Mechanical Technology. We believe Mr. Li's qualifications to serve on our board include his extensive knowledge of the Company and his extensive knowledge and experience of the markets in which we conduct business.

Mr. Yinqing Li, Director, 58. Mr. Yinqing Li is the president of the Institute of Building Fire Research, China Academy of Building Research. Mr. Li also holds several concurrent positions including Secretary-general of the Fire-proof and Comprehensive Technique Institute of the Architectural Society of China, the executive director of the China Fire Protection Association, and the director of the National Fire Standardization Technical Committee. Mr. Li has more than 30 years of experience in the fire protection industry including experience with technology innovation, industry standardization and new product development. Mr. Li has also hosted several fire protection design workshops for the mega-buildings in Beijing including the Beijing Capital Airport Terminal 3, the National Stadium and the National centre for the Performing Arts. Mr. Li received his Bachelor's Degree from Tsinghua University in 1977.

Mr. Guoyou Zhang, Director, 59. 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. We believe Mr. Zhang's qualifications to serve on our board include his extensive knowledge of the Company and his in-depth knowledge of our market and general management.

Mr. Albert McLelland, Director, 52. Mr. 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. Since 2009, Mr. McLelland has been an Independent Director and Chairman of the Audit Committee for Yanglin Soybean, Inc. ("YSYB.OB") and China Housing and Land Development, Inc. ("CHLN"). 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. We believe Mr. McLelland's qualifications to serve on our board include his extensive knowledge of the Company, his experience serving on boards of other companies and the unique perspective he brings to various issues considered by the board, particularly related to finance, accounting and general management.

#### 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”. We do not have a lead independent director, but have independent board members that bring experience, oversight and expertise from outside the Company and our industry.

Audit Committee. The Audit Committee currently comprises 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. Yinqing Li, 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.

The Company has no definitive policy on diversity. With the exception of two directors who are not Chinese citizens, the Company is managed by executives of Chinese citizenship and actively staffs the Company at all levels with employees that are citizens of China. While each member of the board of directors has diversified education background, different industry experiences including government agencies, universities, state-owned enterprises, consulting services, multinational companies, and private owned companies, the board believes that there exists no need for a diversity policy for employees or directors because the Company is diversified when compared to American-based enterprises.

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. Yinqing Li, Mr. Guoyou Zhang, and Mr. Xianghua Li, with Yinqing Li as the chairman.

The Board had 10 meetings during the last fiscal year. All members attended at least 75% of the meetings.

The Board’s Role in Risk Oversight. The Board has an active role in overseeing our risk management. The Board’s role in the Company’s risk oversight process includes receiving regular reports from members of senior management on areas of material risk to the Company, including operational, financial, legal, regulatory, and strategic risks. The full Board receives these reports from the appropriate senior manager within the organization to enable it to

understand the Company's risk identification, risk management and risk mitigation strategies. Upon receiving such reports, the Board provides such guidance as it deems necessary.

#### 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 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).

## 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. Tongzhou Qin, Chief Financial Officer, B-2502 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, stock options and restricted stock. 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. A significant portion of the total compensation paid to our key 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 2010 was \$103.9 million in revenue and \$34.8 million in pre-tax income, representing 28% and 22% growth respectively compared to the results in fiscal year 2009. The actual financial results in 2010 were \$80.8 million in revenue and \$18.7 million in pre-tax income, which missed the financial guidance. Consequently, the bonuses to Mr. Brian Lin and Mr. Tongzhou Qin were not paid in fiscal year 2010.

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 or the restricted shares to be awarded towards the end of the fiscal year. The exercise price for stock options was 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 2010 with respect to the executive officers named in the Compensation Table on page 48.

In 2010, 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 (the "Comparison Group") during the course of discussing and finalizing the compensation for our executives.

|                                | Year 2009 |           |          |                        |       |           |
|--------------------------------|-----------|-----------|----------|------------------------|-------|-----------|
|                                | Salary    | Stock     | Option   | All Other Compensation | Bonus | Total     |
| China Security & Surveillance  |           |           |          |                        |       |           |
| 1 (CSR)                        |           |           |          |                        |       |           |
| CEO                            | \$290,058 |           |          |                        |       | \$290,058 |
| CFO                            | \$315,904 |           |          |                        |       | \$315,904 |
| China Information Security     |           |           |          |                        |       |           |
| 2 Technolgy, Inc. (CPBY)       |           |           |          |                        |       |           |
| CEO                            | 58,644    | \$119,000 |          |                        |       | \$177,644 |
| CFO                            | \$12,500  | 119,000   | -        |                        |       | \$131,500 |
| 3 COGO Group, Inc. (COGO)      |           |           |          |                        |       |           |
| CEO                            | \$74,904  | \$320,600 |          | \$2,251                |       | \$397,755 |
| CFO                            | \$100,000 | \$307,242 |          | \$1,548                |       | \$408,790 |
| 4 Harbin Electric, Inc. (HRBN) |           |           |          |                        |       |           |
| CEO                            | \$26,470  |           | \$11,946 |                        |       | \$38,416  |
| CFO                            | \$15,882  |           | \$7,962  |                        |       | \$23,844  |



5 Shengdatech, Inc. (SDTH)

|     |           |   |           |           |
|-----|-----------|---|-----------|-----------|
| CEO | \$195,000 | - | \$105,000 | \$300,000 |
| CFO | \$92,500  | - | \$49,850  | \$142,350 |

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|                                       |           |             |           |          |             |
|---------------------------------------|-----------|-------------|-----------|----------|-------------|
| 6 Wonder Auto Technology, Inc. (WATG) |           |             |           |          |             |
| CEO                                   | \$120,000 |             | \$524,935 |          | \$644,935   |
| CFO                                   | \$80,000  |             | \$174,978 |          | \$254,978   |
| 7 Fushi Copperweld, Inc. FSIN         |           |             |           |          |             |
| CEO                                   | \$79,000  | \$404,000   | \$856,000 | \$30,000 | \$1,369,000 |
| CFO                                   | \$200,000 |             | \$93,000  | \$64,000 | \$357,000   |
|                                       |           | Highest     | Lowest    |          |             |
| CEO                                   |           | \$1,369,000 | \$38,416  |          |             |
| CFO                                   |           | \$408,790   | \$23,844  |          |             |

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 2009.

In 2010, the proposed compensation for Mr. Brian Lin was as follows:

Cash Compensation: \$150,000 where the Base Salary is \$120,000 (80%) and the Bonus is \$30,000 (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 Mr. Brian Lin.

Equity Compensation: On January 2, 2009, the Company issued 300,000 stock options to Brian Lin, with exercise price at \$6.81 which was the closing price of the Company stock on December 31, 2008. On December 1, 2009, the Company issued 100,000 shares of restricted stocks to Brian Lin. There is no additional equity based compensation for Mr. Lin during 2010. During the year of 2010, 75,000 shares of options and 25,000 shares of restricted stocks were vested and released to Brian Lin. .

In 2010, the proposed compensation for Mr. Tongzhou, Qin is as follows:

Cash Compensation: \$100,000 where the Base Salary is \$80,000 (80%) and the Bonus is \$20,000 (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 Mr. Tongzhou Qin.

Equity Compensation: On December 1, 2009, the Company issued 20,000 shares of restricted stocks to Tongzhou Qin. There is no additional equity based compensation for Mr. Qin during 2010. During the year of 2010, 5,000 shares of restricted stocks were released to Tongzhou Qin.

Based on its review in 2010, 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. Tongzhou Qin, our CFO were determined based on the range of compensation for the above Comparison Group. The actual compensation for Mr. Brian Lin in fiscal year 2010 was \$725,750, which fell within the targeted parameters of \$38,416 and \$1,369,000 for CEOs. The actual compensation for Tongzhou Qin in fiscal year 2010 was \$143,250, which fell within the targeted parameters of \$23,844 and \$408,790 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 Omnibus Long-term Incentive 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.

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 options to purchase 1,000,000 shares for its employees with options to purchase a total of 800,000 shares issued to executive officers. The options will vest evenly each quarter over the following four years, starting from the first quarter of 2009.

Based on the compensation reported by the Company for 2008 and 2009, the Committee determined that the overall compensation for the management team and some key employees of the Company are below the market or at the low end of the market, compared to public companies of similar size in China. The Committee deems it in the best interests of the Company and its shareholders to bring the level of compensation for its management and key employees to that of the market and to issue shares of restricted stock to supplement cash compensation for its management and key employees in order to provide incentives to and retain qualified employees. The Committee recommended that shares of the restricted stock be issued pursuant to the terms and conditions of the Company's 2008 Omnibus Long Term Incentive Stock Option Plan for its officers and key employees, to supplement the cash compensation of these officers and key employees for the next four years. The committee further recommend to issue one million shares of the restricted stock which will vest from the date of issuance, in four equal installments, with one installment due every twelve months.

On December 1, 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 restricted stocks to its employees, with 285,000 shares of restricted stocks issued to the executive officers. The restricted stocks will vest evenly at the end of each year over the following four years, starting from November 30, 2010.

#### Compensation Policies and Practices as Related to Risk Management

##### Risk Considerations in our Compensation Program

The Compensation Committee has discussed the concept of risk as it relates to our compensation programs. In particular, the Compensation Committee assessed whether any such programs encourage excessive or inappropriate risk taking. The Compensation Committee considered the allocation of compensation among base salary, bonus and equity-based compensation, our approach to establishing company-wide and individual financial, operational and other performance targets, with payouts at multiple levels of performance and minimum levels of achievement, and evaluation of key performance metrics, each of which assists in mitigating excessive risk-taking that could harm our value. The assessment resulted in a determination that our current compensation programs, practices or policies facilitate the appropriate balance between prudent business risk and resulting compensation that does not encourage excessive risk-taking or create potential risks that are reasonably likely to have a material adverse effect on the Company.

##### Compensation Table

| Name & Principal Position | Year | Salary     | Bonus | Option* Awards | Restricted Stocks | Total      |
|---------------------------|------|------------|-------|----------------|-------------------|------------|
| Brian Lin, CEO            | 2010 | \$ 120,000 | \$    | \$ 289,500     | \$ 316,250        | \$ 725,750 |

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|                      |      |    |        |    |        |         |       |        |        |            |
|----------------------|------|----|--------|----|--------|---------|-------|--------|--------|------------|
|                      | 2009 | \$ | 84,000 | \$ | \$     | 289,500 | \$    | 26,354 | \$     | 399,854    |
|                      | 2008 | \$ | 84,000 | \$ | 36,000 | \$      | 4,200 | \$     |        | \$ 124,200 |
| Tongzhou Qin,<br>CFO | 2010 | \$ | 80,000 | \$ |        | \$      | 0     | \$     | 63,250 | \$ 143,250 |

\* The assumptions made in valuing the option were disclosed in the financial statements Note 14.

## Grants of Plan-Based Awards

The following table provides information relating to our grants of plan-based awards in the fiscal year ended December 31, 2010.

| Name         | Restricted stocks/Options | Grant date     | Total share number of future payouts | Base/exercise price of restricted stock/option awards (\$/Sh) | Grant date fair value of restricted stock/option awards (\$) |
|--------------|---------------------------|----------------|--------------------------------------|---|--|
| Brian Lin    | Options                   | Jan. 2nd, 2009 | 300,000                              | 6.81  | 1,105,200  |
|              | Restricted stocks         | Dec. 1st, 2009 | 100,000                              | 12.65   | 1,265,000  |
| Tongzhou Qin | Restricted stocks         | Dec. 1st, 2009 | 20,000                               | 12.65   | 253,000  |

## Outstanding Equity Awards at Fiscal Year-End Table

The following table provides information concerning unexercised options and restricted stock that has not vested, and equity incentive plan awards for our named executive officers outstanding as of December 31, 2010.

| Name         | Option/Restricted Stock | Number of Securities                                     |  | Equity Awards Incentive Plan Awards:                    |   | Option Exercise Price (\$)/Stock Base Price (\$) | Option Expiration Date |
|--------------|-------------------------|--|--|---|---|--|------------------------|
|              |                         | Underlying Unexercised (#) Exercisable/Restricted Stocks | Underlying Unexercised (#) Exercisable/Restricted Stocks | Number of Securities Underlying Unexercised Options (#) | Number of Securities Underlying Unexercised Options (#) |  |                        |
| Brian Lin    | Option                  | 150,000  | -  | -   | -   | 1.25   | Jun. 30, 2016          |
|              | Option                  | 150,000  | 150,000  | 243,750   | 75,000  | 6.81   | Jan. 1, 2014           |
|              | Restricted Stock        | 25,000   | 75,000   | 75,000  |   | 12.65  |                        |
| Tongzhou Qin | Option                  | 5,000  | 15,000   |   |   | 12.65  | Jun 30, 2012           |

## Option Exercises and Stock Vested

No options were exercised in 2010.

On November 30, 2010, 250,000 shares of restricted stocks were released to the Company's employees.

## 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 2010.

## 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, 2010.

## 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 (\$) |
|------------------|----------------------------------|-------------------|--------------------|---|---|-----------------------------|------------|
| Guoyou Zhang     | 21,114                           |                   |                    |   |   |                             | 21,114     |
| Xuewen Xiao      | 21,114                           |                   |                    |   |   |                             | 21,114     |
| Xianghua Li      | 17,595                           |                   |                    |   |   |                             | 17,595     |
| Albert McLelland | 55,000                           |                   |                    |   |   |                             | 55,000     |

## 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. Yinqing Li

## 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 27,855,934 shares of Common Stock and 1,576,857 stock options that are exercisable within 60 days from March 15, 2011:

each person who is known by us to be the beneficial owner of more than 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 )                       | 43.8 %           |
| Common         | China Honor Investment Limited        | 2,667,600 (2 )                        | 9.1 %            |
| Common         | Weigang Li                            | 15,637,475 (3 )                       | 53.6 %           |
| Common         | Jincai Li                             | 15,435,600 (4 )                       | 52.9 %           |

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|        |   |            |     |   |      |   |
|--------|---|------------|-----|---|------|---|
| Common | Brian Lin   | 1,130,350  | (5  | ) | 3.9  | % |
| Common | Weishe Zhang  | 693,150    | (6  | ) | 2.4  | % |
| Common | Tongzhou Qin  | 5,000      | (7  | ) | 0.0  | % |
| Common | Xiaoyuan Yuan   | 17,500     | (8  | ) | 0.1  | % |
| Common | Albert Mclelland  | -          |     |   | 0.0  | % |
| Common | Yinqing Li  | -          |     |   | 0.0  | % |
| Common | Xianghua Li   | -          |     |   | 0.0  | % |
| Common | Guoyou Zhang  | 2,000      | (9  | ) | 0.0  | % |
| Common | Directors and executive officers as a group (9 persons) | 17,485,475 | (10 | ) | 59.9 | % |

\* The address for the officers and directors is B-2502 TYG Center, C2 Dongsanhuanbeilu, Chaoyang District, Beijing 100027, Beijing 100027, People's Republic of China, (86-10) 8441-7400.

- (1) Weigang Li and Ms. Jincai Li, as directors, share the voting power of Li Brothers Holding Inc.. Future Champion Limited and Alpha Great Holdings Limited are the shareholders of Li Brothers Holding Inc., each holding 50% of the outstanding shares of Li Brothers Holding Inc respectively. Jade Ground Holdings Limited owns 100% of the outstanding shares of Alpha Great Holdings Limited. LGJ Family Trust owns 100% of the outstanding shares of Jade Ground Holdings Limited. Magic Express Limited owns 100% of the outstanding shares of Future Champion Limited. LWG Family Trust owns 100% of the outstanding shares of Magic Express Limited. Mr. Weigang Li, is the brother of Ms. Jincai Li.
- (2) Mr. Weigang Li and Ms. Jincai Li, as directors, share the voting power of China Honor Investment Limited. Alpha Great Holdings Limited owns 100% of the outstanding shares of China Honor Investment Limited. Jade Ground Holdings Limited owns 100% of the outstanding shares of Alpha Great Holdings Limited. LGJ Family Trust owns 100% of the outstanding shares of Jade Ground Holdings Limited. Mr. Weigang Li, is the brother of Ms. Jincai Li.
- (3) Represents his voting power of Li Brothers Holding Inc. and China Honor Investment Limited plus his options to purchase 201,875 shares of Common Stock that is exercisable within 60 days from March 15, 2011 and 17,500 shares of released restricted stocks.
- (4) Represents her voting power of Li Brothers Holding Inc. and China Honor Investment Limited.
- (5) Represents his indirect beneficial ownership China Fire & Security Group, Inc. through Vyle Investment Inc. of which he is the sole director with 100% voting power plus his options to purchase 318,750 shares of Common Stock that is exercisable within 60 days from March 15, 2011 and 25,000 shares of released restricted stocks. Master Crest Holdings Limited, a BVI company, owns 100% of the outstanding shares of Vyle Investment Inc. Master Crest Holdings Limited is 100% owned by BL Family Trust, a Foreign Grantor Trust registered in Cayman Islands.
- (6) Represents his indirect beneficial ownership of China Fire & Security Group Inc. through Small Special Technology Inc. of which he is the sole director with 100% voting power plus his options to purchase 168,750 shares of Common Stock that is exercisable within 60 days from March 15, 2011.
- (7) Represents 5,000 shares of released restricted stocks.

- (8) Represents his options to purchase 18,750 shares of Common Stock that is exercisable within 60 days from March 15, 2011.
- (9) Represents his options to purchase 2,000 shares of Common Stock that is exercisable within 60 days from March 15, 2011.
- (10) Represents the number of shares of Common Stock plus options to purchase 692,625 shares of Common Stock that is exercisable within 60 days from March 15, 2011 and 47,500 shares of released restricted stocks.

### Item 13. Certain Relationships And Related Transactions and Director Independence

The Company has receivables from Hubei Shou An Changjiang Fire Protection Co., Ltd. (“Hubei Shou An”), in which the Company has a 19% ownership interest. The accounts receivable due from Hubei Shou An was \$160,731 and \$155,433 as of December 31, 2010 and 2009, respectively, which resulted from product sales of \$57,016 and \$41,045 for the years ended December 31, 2010 and 2009, respectively. This amount is expected to be repaid by December 31, 2011 in cash.

In addition, the Company has other receivable from Hubei Shou An in the amounts of \$234,042 and \$396,359 as of December 31, 2010 and 2009, respectively. This balance was for operating capital in Hubei Shou An and is expected to be repaid by December 31, 2011 in cash.

The Company has prepayments to Tianjin Tianxiao Fire Safety Equipment Co., Ltd., in which the Company has 16.7% ownership interest. The prepayment to Tianjin Tianxiao Fire Safety Equipment Co., Ltd. was \$1,603,123 as of December 31, 2010 and accounts payable were \$272,994 as of December 31, 2009, resulting from product purchases of \$4,465,084 and \$1,465,842 for the years ended December 31, 2010 and 2009, respectively, after the restructuring of 83.3% ownership interest in Tianxiao Equipment.

Advance payments to Sureland India, in which the Company has 5.0% ownership interest, were \$450,170 and \$103,174 as of December 31, 2010 and 2009, respectively. This balance was for the advance payment to Sureland India for the delivery of future services.

In 2007, our Board of Directors approved and adopted its Policy of Related-Party Transactions (the “Policy”). According to the Policy, any related-party transactions with value above 30 million RMB (or \$4.5 million) or 5% of total net assets requires the approval of the Board of Directors as well as the shareholders. Any related party transactions with value between 3 million RMB (or \$0.5 million) and 30 million RMB (or \$4.5 million) or between 0.5% and 5% of total net assets requires the approval of the Board of Directors. Any related party transaction with value less than 3 million RMB (or \$0.5 million) requires the approval of the chief executive officer of the Company. Under the Policy any of such related parties will not participate in the approval process for the transaction for which they are considered to be related parties.

### Item 14. Principal Accounting Fees And Services

We were notified that, effective January 1, 2010, certain partners of its previous independent accounting firm, Moore Stephens Wurth Frazer and Torbet, LLP (“MSWFT”), and certain partners of Frost, PLLC (“Frost”) formed Frazer Frost, LLP (“Frazer Frost”), a new partnership. Pursuant to the terms of a combination agreement by and among MSWFT, Frazer Frost and Frost (the “Combination Agreement”), each of MSWFT and Frost contributed all of their assets and certain of their liabilities to Frazer Frost, resulting in Frazer Frost assuming MSWFT’s engagement letter with us. On January 7, 2010, the Audit Committee of our Board of Directors approved the engagement of Frazer Frost as MSWFT’s successor to continue as our independent accounting firm.

Frazer Frost, LLP (Successor entity of 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 Frazer Frost, LLP, (Successor entity of 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, 2010, 2009 and 2008 totaled approximately \$320,000, \$320,000 and \$245,000, respectively.

Audit-Related Fees

No fees were paid or accrued by us for assurance and related services rendered by Frazer Frost, LLP, (Successor entity of 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, 2010, 2009 and 2008.

Tax Fees

\$10,000, \$10,000 and \$10,000 were paid or accrued by us for professional services rendered by Frazer Frost, LLP, (Successor entity of Moore Stephens Wurth Frazer and Torbet, LLP), for tax compliance, tax advice and tax planning for the fiscal years December 31, 2010, 2009 and 2008, respectively.

All Other Fees

No fees were paid or accrued by us for other services rendered by Frazer Frost, LLP, (Successor entity of Moore Stephens Wurth Frazer and Torbet, LLP), for the fiscal years ended December 31, 2010, 2009 and 2008.

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

|  |            |
|--|------------|
| <u>Report of Independent Registered Public Accounting Firm</u>   | <u>F-1</u> |
| <u>Consolidated Balance Sheets at December 31, 2010 and 2009</u>   | <u>F-2</u> |
| <u>Consolidated Statements of Income and Other Comprehensive Income for the Years Ended December 31, 2010, 2009 and 2008</u> | <u>F-3</u> |
| <u>Consolidated Statements of Changes in Equity</u>  | <u>F-4</u> |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2010, 2009 and 2008</u>                            | <u>F-5</u> |
| <u>Notes to Consolidated Financial Statements</u>  | <u>F-6</u> |

(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 to be signed on its behalf by the undersigned, thereunto duly authorized, in Beijing.

CHINA FIRE & SECURITY GROUP, INC.

Dated: March 16, 2011

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 has been signed by the following persons in the capacities indicated as of March 16, 2011.

| Signature                                | Title  |
|--|--|
| /s/ Weigang Li<br>Weigang Li             | Chairman of the Board                                    |
| /s/ Brian Lin<br>Brian Lin               | Chief Executive Officer<br>(Principal Executive Officer) |
| /s/ Tongzhou Qin<br>Tongzhou Qin         | Chief Financial Officer<br>(Principal Financial Officer) |
| /s/ Xiaoyuan Yuan<br>Xiaoyuan Yuan       | Principal Accounting Officer                             |
| /s/ Weishe Zhang<br>Weishe Zhang         | Director and Vice President                              |
| /s/ Guoyou Zhang<br>Guoyou Zhang         | Director   |
| /s/ Yinqing Li<br>Yongqing Li            | Director   |
| /s/ Xianghua Li<br>Xianghua Li           | Director   |
| /s/ Albert McLelland<br>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, 2010 and 2009, and the related consolidated statements of income and other comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2010. 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, 2010 and 2009, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2010 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. and subsidiaries' internal control over financial reporting as of December 31, 2010, 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, 2011 expressed an unqualified opinion.

/s/ Frazer Frost, LLP

Brea, California  
March 16, 2011

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## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2010 AND 2009

|   | December 31,<br>2010 | December 31,<br>2009 |
|---|----------------------|----------------------|
| <b>ASSETS</b>   |                      |                      |
| <b>CURRENT ASSETS:</b>  |                      |                      |
| Cash and cash equivalents   | \$ 28,151,689        | \$ 34,976,880        |
| Restricted cash   | 1,935,979            | 1,837,134            |
| Notes receivable  | 14,428,802           | 4,274,268            |
| Accounts receivable, net of allowance for doubtful accounts of \$8,153,727 and \$6,539,787 as of December 31, 2010 and 2009, respectively | 41,895,129           | 30,989,569           |
| Receivables from and prepayments to related parties   | 2,448,066            | 551,792              |
| Other receivables   | 792,386              | 368,679              |
| Refundable bidding and system contracting project deposits  | 1,667,437            | 1,774,330            |
| Inventories   | 6,713,448            | 5,360,520            |
| Costs and estimated earnings in excess of billings  | 40,660,013           | 36,562,573           |
| Employee advances   | 1,114,080            | 953,625              |
| Prepayments and deferred expenses   | 10,281,292           | 3,397,358            |
| Total current assets  | 150,088,321          | 121,046,728          |
| PLANT AND EQUIPMENT, net  | 9,641,119            | 8,617,521            |
| <b>OTHER ASSETS:</b>  |                      |                      |
| Restricted cash - non current   | 7,533,407            | 3,602,906            |
| Accounts receivable - retentions  | 2,790,492            | 3,463,998            |
| Deferred expenses - non current   | -                    | 116,045              |
| Investment in joint ventures  | 496,834              | 477,837              |
| Intangible assets, net  | 985,643              | 1,041,156            |
| Total other assets  | 11,806,376           | 8,701,942            |
| Total assets  | \$ 171,535,816       | \$ 138,366,191       |
| <b>LIABILITIES AND EQUITY</b>   |                      |                      |
| <b>CURRENT LIABILITIES:</b>   |                      |                      |
| Accounts payable  | \$ 7,666,967         | \$ 6,903,961         |
| Accounts payable to related party   | -                    | 272,994              |
| Customer deposits   | 3,023,329            | 2,182,790            |
| Billings in excess of costs and estimated earnings  | 2,872,706            | 1,429,999            |
| Other payables  | 838,413              | 333,121              |
| Accrued liabilities   | 19,737,906           | 13,841,300           |
| Taxes payable   | 9,416,829            | 9,002,470            |
| Total current liabilities   | 43,556,150           | 33,966,635           |

## COMMITMENTS AND CONTINGENCIES

## Equity:

|   |                |                |
|---|----------------|----------------|
| Common stock, \$0.001 par value, 65,000,000 shares authorized,<br>27,855,934 and 27,595,541 shares issued and outstanding<br>as of December 31, 2010 and 2009, respectively | 27,855         | 27,595         |
| Additional paid-in-capital  | 24,771,143     | 20,601,138     |
| Subscriptions receivable  | (27,570 )      | -              |
| Statutory reserves  | 7,147,795      | 7,147,795      |
| Retained earnings   | 84,703,984     | 69,266,049     |
| Accumulated other comprehensive income  | 11,349,619     | 7,324,237      |
| Total shareholders' equity  | 127,972,826    | 104,366,814    |
| Noncontrolling interest   | 6,840          | 32,742         |
| Total equity  | 127,979,666    | 104,399,556    |
| Total liabilities and equity  | \$ 171,535,816 | \$ 138,366,191 |

See report of independent registered public accounting firm.

The accompany notes are integral part of these consolidated financial statements.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

|   | 2010              | 2009              | 2008              |
|---|-------------------|-------------------|-------------------|
| <b>REVENUES</b>   |                   |                   |                   |
| System contracting projects   | \$59,544,090      | \$62,514,475      | \$57,101,984      |
| Products  | 16,834,582        | 15,718,815        | 9,673,922         |
| Maintenance services  | 3,598,010         | 2,947,908         | 2,303,213         |
| Total revenues  | 79,976,682        | 81,181,198        | 69,079,119        |
| <b>COST OF REVENUES</b>   |                   |                   |                   |
| System contracting projects   | 28,897,445        | 26,769,508        | 25,805,086        |
| Products  | 7,342,962         | 5,589,310         | 2,558,844         |
| Maintenance services  | 2,457,833         | 1,769,104         | 1,217,316         |
| Total cost of revenues  | 38,698,240        | 34,127,922        | 29,581,246        |
| <b>GROSS PROFIT</b>   | <b>41,278,442</b> | <b>47,053,276</b> | <b>39,497,873</b> |
| <b>OPERATING EXPENSES</b>   |                   |                   |                   |
| Selling and marketing   | 10,135,884        | 8,908,697         | 6,434,887         |
| General and administrative  | 10,822,596        | 8,154,801         | 6,680,992         |
| Depreciation and amortization   | 851,036           | 773,907           | 712,269           |
| Research and development  | 1,966,557         | 1,631,435         | 2,102,976         |
| Total operating expenses  | 23,776,073        | 19,468,840        | 15,931,124        |
| <b>INCOME FROM OPERATIONS</b>   | <b>17,502,369</b> | <b>27,584,436</b> | <b>23,566,749</b> |
| <b>OTHER INCOME</b>   |                   |                   |                   |
| Other income, net   | 617,553           | 671,623           | 802,299           |
| Interest income, net  | 443,063           | 269,081           | 382,227           |
| Total other income, net   | 1,060,616         | 940,704           | 1,184,526         |
| <b>INCOME BEFORE PROVISION FOR INCOME TAXES AND<br/>NONCONTROLLING INTEREST</b> | <b>18,562,985</b> | <b>28,525,140</b> | <b>24,751,275</b> |
| <b>PROVISION FOR INCOME TAXES</b>   | <b>3,210,378</b>  | <b>4,165,548</b>  | <b>47,423</b>     |
| <b>NET INCOME BEFORE NONCONTROLLING INTEREST</b>                                | <b>15,352,607</b> | <b>24,359,592</b> | <b>24,703,852</b> |
| Less: Net loss attributable to noncontrolling interest                          | (85,328 )         | (55,244 )         | -                 |
| <b>NET INCOME ATTRIBUTABLE TO CONTROLLING INTEREST</b>                          | <b>15,437,935</b> | <b>24,414,836</b> | <b>24,703,852</b> |
| <b>OTHER COMPREHENSIVE INCOME</b>   |                   |                   |                   |
| Foreign currency translation adjustment   | 4,025,382         | 19,093            | 3,737,027         |
| Comprehensive (income) loss attributable to noncontrolling interest             | 986               | (17 )             | -                 |

|                                   |               |               |               |
|-----------------------------------|---------------|---------------|---------------|
| <b>COMPREHENSIVE INCOME</b>       | \$ 19,464,303 | \$ 24,433,912 | \$ 28,440,879 |
| <b>BASIC EARNINGS PER SHARE</b>   |               |               |               |
| Weighted average number of shares | 27,618,465    | 27,590,523    | 27,568,214    |
| Earnings per share                | \$0.56        | \$0.88        | \$0.90        |
| <b>DILUTED EARNINGS PER SHARE</b> |               |               |               |
| Weighted average number of shares | 29,568,429    | 28,311,955    | 28,210,620    |
| Earnings per share                | \$0.52        | \$0.86        | \$0.88        |

See report of independent registered public accounting firm.  
 The accompany notes are integral part of these consolidated financial statements.

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## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

|   | China Fire & Security Group, Inc. Shareholders' Equity |              |                               |                             |  |              |  |                            | Total        |
|---|--|--------------|-------------------------------|-----------------------------|--|--------------|--|----------------------------|--------------|
|   | Common Stock<br>Shares                                 | Par<br>value | Additional<br>paid-in-capital | Subscriptions<br>receivable | Retained Earnings<br>Statutory<br>reserves | Unrestricted | Accumulated other<br>comprehensive<br>income | Noncontrolling<br>interest |              |
| BALANCE,<br>December 31,<br>2007                            | 27,556,893   | \$27,556     | \$19,317,287                  | \$-                         | \$5,067,061                                | \$22,228,095 | \$3,568,117                                  | \$-                        | \$50,200,000 |
| Net income  |  |              |                               |                             |  | 24,703,852   |  |                            | 24,703,852   |
| Warrants<br>exercised                                       | 29,700   | 30           | (30)                          |                             |  |              |  |                            | -            |
| Options<br>issued to<br>employees                           |  |              | 40,152                        |                             |  |              |  |                            | 40,152       |
| Adjustment of<br>statutory<br>reserves                      |  |              |                               |                             | 2,081,766                                  | (2,081,766)  |  |                            | -            |
| Foreign<br>currency<br>translation<br>adjustment            |  |              |                               |                             |  |              | 3,737,027                                    |                            | 3,737,027    |
| BALANCE,<br>December 31,<br>2008                            | 27,586,593   | \$27,586     | \$19,357,409                  | \$-                         | \$7,148,827                                | \$44,850,181 | \$7,305,144                                  | \$-                        | \$78,689,000 |
| Capital received from<br>noncontrolling interest            |  |              |                               |                             |  |              |  | 88,003                     | 88,003       |
| Net income  |  |              |                               |                             |  | 24,414,836   |  | (55,244)                   | 24,359,592   |
| Warrants<br>exercised                                       | 6,682  | 7            | (7)                           |                             |  |              |  |                            | -            |
| Options<br>exercised  | 2,266  | 2            | (2)                           |                             |  |              |  |                            | -            |
| Options<br>issued to<br>employees                           |  |              | 980,196                       |                             |  |              |  |                            | 980,196      |
| Stock based<br>compensation<br>for services                 |  |              | 263,542                       |                             |  |              |  |                            | 263,542      |
| Deconsolidation of<br>statutory reserves held in<br>Tianjin |  |              |                               |                             | (1,032)                                    | 1,032        |  |                            | -            |

Tianxiao Fire Safety  
Equipment Co., Ltd.

|  |            |        |            |          |           |            |            |          |       |   |
|--|------------|--------|------------|----------|-----------|------------|------------|----------|-------|---|
| Foreign<br>currency<br>translation<br>adjustment |            |        |            |          |           |            | 19,093     | (17 )    | 19,07 | - |
| <b>BALANCE,</b><br>December 31,<br>2009          | 27,595,541 | 27,595 | 20,601,138 | -        | 7,147,795 | 69,266,049 | 7,324,237  | 32,742   | 104,3 |   |
| Capital received from<br>noncontrolling interest |            |        |            |          |           |            |            | 58,440   | 58,44 |   |
| Options<br>exercised                             | 10,393     | 10     | 27,560     | (27,570) |           |            |            |          | -     |   |
| Restricted<br>shares issued                      | 250,000    | 250    | (250 )     |          |           |            |            |          | -     |   |
| Net income                                       |            |        |            |          |           | 15,437,935 |            | (85,328) | 15,35 |   |
| Options<br>issued to<br>employees                |            |        | 980,195    |          |           |            |            |          | 980,1 |   |
| Stock based<br>compensation<br>for services      |            |        | 3,162,500  |          |           |            |            |          | 3,162 |   |
| Foreign<br>currency<br>translation<br>adjustment |            |        |            |          |           |            | 4,025,382  | 986      | 4,026 |   |
| <b>BALANCE,</b><br>December 31,<br>2010          | 27,855,934 | 27,855 | 24,771,143 | (27,570) | 7,147,795 | 84,703,984 | 11,349,619 | 6,840    | 127,9 |   |

See report of independent registered public accounting firm.  
The accompany notes are integral part of these consolidated financial statements.



## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009, AND 2008

|   | 2010          | 2009          | 2008          |
|---|---------------|---------------|---------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                  |               |               |               |
| Net income attributable to controlling interest                               | \$ 15,437,935 | \$ 24,414,836 | \$ 24,703,852 |
| Net loss attributable to noncontrolling interest                              | (85,328 )     | (55,244 )     | -             |
| Consolidated net income   | 15,352,607    | 24,359,592    | 24,703,852    |
| Adjustments to reconcile net income to cash provided by operating activities: |               |               |               |
| Depreciation  | 836,537       | 766,473       | 728,080       |
| Amortization  | 75,382        | 75,284        | 75,041        |
| Provision for doubtful accounts   | 1,894,361     | 2,172,588     | 1,683,336     |
| Recovery of doubtful allowance  | (540,913 )    | -             | -             |
| (Gain) loss on disposal of equipment  | 36,041        | (7,602 )      | (35,689 )     |
| Options issued to employees   | 980,195       | 980,196       | 40,152        |
| Stock based compensation for services   | 3,162,500     | 263,542       | -             |
| Provision for estimated warranty claims                                       | 383,744       | 582,595       | 518,940       |
| Change in operating assets and liabilities                                    |               |               |               |
| Notes receivable  | (9,738,344 )  | (603,639 )    | (120,143 )    |
| Accounts receivable   | (10,180,721)  | (9,875,285 )  | (10,571,077)  |
| Receivables from and prepayments to related parties                           | (1,537,903 )  | (85,517 )     | (458,119 )    |
| Other receivables   | (405,386 )    | 50,740        | (159,199 )    |
| Refundable bidding and system contracting project deposits                    | 166,503       | (689,560 )    | (559,757 )    |
| Inventories   | (1,140,231 )  | (63,808 )     | (2,168,821 )  |
| Costs and estimated earnings in excess of billings                            | (2,774,211 )  | (18,729,367)  | (3,771,899 )  |
| Employee advances   | (124,494 )    | (227,973 )    | 663,369       |
| Prepayments and deferred expenses   | (6,471,415 )  | (676,908 )    | (412,888 )    |
| Accounts payable  | 736,504       | 666,007       | (98,219 )     |
| Accounts payable related party  | (272,994 )    | 272,994       | -             |
| Customer deposits   | 748,442       | (3,907,650 )  | 994,154       |
| Billings in excess of costs and estimated earnings                            | 1,356,293     | (2,805,806 )  | (969,403 )    |
| Other payables  | 480,704       | (485,243 )    | 645,855       |
| Accrued liabilities   | 4,678,319     | 6,503,713     | 1,722,071     |
| Taxes payable   | 108,211       | 6,932,390     | 912,068       |
| Net cash (used in) provided by operating activities                           | (2,190,269 )  | 5,467,756     | 13,361,704    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                  |               |               |               |
| Purchase of plant and equipment   | (1,601,015 )  | (1,272,393 )  | (2,015,051 )  |
| Proceeds from sale of equipment   | 18,155        | 26,859        | 69,852        |
| Payments for long term deferred assets  | -             | (115,973 )    | -             |
| Deconsolidation of cash held at Tianxiao Fire Equipment Co. Ltd.              | -             | (241,344 )    | -             |
| Proceeds from restructuring of Tianxiao Fire Safety Equipment Co. Ltd.        | -             | 1,551,134     | -             |
| Proceeds from investment sold in King Galaxy Investments Limited              | -             | 1,000,000     | -             |

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|   |                     |                     |                     |
|---|---------------------|---------------------|---------------------|
| Net cash (used in) provided by investing activities   | (1,582,860 )        | 948,283             | (1,945,199 )        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                     |                     |                     |
| Change in restricted cash   | (3,754,928 )        | 1,809,610           | (3,097,855 )        |
| Capital contributed by noncontrolling interest shareholder  | 59,040              | 88,003              | -                   |
| Net cash (used in) provided by financing activities   | (3,695,888 )        | 1,897,613           | (3,097,855 )        |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>  | <b>643,826</b>      | <b>7,895</b>        | <b>1,226,234</b>    |
| <b>INCREASE (DECREASE) IN CASH</b>  | <b>(6,825,191 )</b> | <b>8,321,547</b>    | <b>9,544,884</b>    |
| <b>CASH and CASH EQUIVALENTS, beginning of year</b>   | <b>34,976,880</b>   | <b>26,655,333</b>   | <b>17,110,449</b>   |
| <b>CASH and CASH EQUIVALENTS, end of year</b>   | <b>\$28,151,689</b> | <b>\$34,976,880</b> | <b>\$26,655,333</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>   |                     |                     |                     |
| Income taxes paid   | \$4,509,569         | \$1,300,439         | \$29,048            |
| Interest paid   | \$-                 | \$-                 | \$-                 |
| <b>NON-CASH TRANSACTIONS INVESTING AND FINANCING ACTIVITIES:</b>  |                     |                     |                     |
| Reclassification of advances on building and equipment purchase to plant and equipment upon receipt of purchase | \$-                 | \$249,859           | \$139,638           |

See report of independent registered public accounting firm.  
The accompany notes are integral part of these consolidated financial statements.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2010

Note 1 - Background

Principal activities and reorganization

China Fire & Security Group Inc. (the “Company” or “CFSG”), 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 the People’s Republic of China (“PRC”) and India.

Recent developments

Investment of 5% interest in Sureland Fire & Security India Private Ltd (“Sureland India”)

Sureland India was incorporated in New Delhi, India with registered capital of \$51,398 (INR2,500,000). Sureland India engages in project design, consulting and construction services for the fire protection industry in India. In January 2010, Sureland India received approval from the Indian government to accept foreign investment of 5% equity from the Company’s wholly-owned subsidiary China Fire Protection Group, Inc. (CFPG). CFPG has completed the payment of \$2,710 (INR125,000) in January 2010. After the transaction, the Company became a minority interest holder of Sureland India and the investment was recorded under the cost accounting method. The Company made an advance payment to Sureland India in amount of \$450,169 as of December 31, 2010 for future services.

Acquisition of 99% ownership interest and 1% controlling interest in Zeetech System Private Ltd. (“Zeetech”)

Zeetech was incorporated in New Delhi, India with registered capital of \$2,215 (INR101,000). On February 4, 2010, CFPG signed an agreement to acquire 99% ownership and 1% controlling interest in Zeetech from the existing shareholders for \$2,215 (INR101,000), approximately equal to the fair value of the net assets as of January 12, 2010. Zeetech is 100% controlled by CFPG with 99% direct holding and 1% through nominee holding where the nominee agrees to hold the shares on behalf of CFPG. Zeetech does not currently have any operations.

Restructuring of Sureland Industrial

During the first quarter of 2010, CFPG entered into an agreement with Zeetech, our 100% controlled subsidiary, to transfer CFPG’s entire interest (75%) in Sureland Industrial shall be transferred to Zeetech. On March 12, 2010, the restructuring transaction was approved by the Chinese Ministry of Commerce. During the fourth quarter of 2010, CFPG entered into an agreement with Zeetech, pursuant to which Zeetech’s entire interest (75%) in Sureland Industrial Fire Safety Limited (“Sureland Industrial”) shall be reverted back to CFPG. On December 9, 2010, the reverse transaction was approved by the Chinese Ministry of Commence. Subsequent to the transaction, CFSG still holds 100% of the interests in Sureland Industrial through its subsidiaries.

Formation of Shenyang Hongshida Electronics Co., Ltd (“Shenyang Hongshida”)

Shenyang Hongshida was incorporated in Shenyang, Liaoning Province, China with registered capital of \$1,497,000 (RMB10,000,000). Pursuant to Shenyang Hongshida’s by-laws dated June 1, 2009, the registered capital is required to be injected over the subsequent two years. Shenyang Hongshida is 80% owned by our wholly-owned subsidiary, Beijing Hua An, with a 20% noncontrolling interest owned by an unrelated party. Shenyang Hongshida, which is in the pre-operating stage, will engage in the production and sale of fire equipment, electronic products, instrumentation, and computer parts and provision of technical advisory services. Shenyang Hongshida will focus on the low- to

middle-end segment of the fire products market. As of December 31, 2010, \$748,500 (RMB 5,000,000) of the registered capital of Shenyang Hongshida has been received, including \$299,400 (RMB 2,000,000) in June 2010, which \$58,880 (RMB 400,000) was received from the non-controlling interest investor.

Note 2 - Summary of significant accounting policies

The reporting entity

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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                  | %     |
| Zeetech System Private Limited (“Zeetech”)                               | India                  | 99                   | % (1) |
| Sureland Industrial Fire Safety Limited (“Sureland Industrial”)          | PRC                    | 100                  | %     |
| Sureland Industrial Fire Equipment Co. Ltd. (“Sureland Equipment”)       | PRC                    | 100                  | %     |
| Beijing Hua An Times Fire Safety Technology Co., Ltd. (“Beijing Hua An”) | PRC                    | 100                  | %     |
| Beijing Shian Kexin Technology Co., Ltd                                  | PRC                    | 100                  | %     |
| Shenyang Hongshida Electronics Co., Ltd                                  | PRC                    | 80                   | %     |

(1) CFPG has 1% controlling interest in Zeetech through nominee holding where the nominee agrees to hold the shares on behalf of CFPG.

#### 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 in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Management believes that the estimates utilized in preparing the consolidated financial statements are reasonable and prudent. Actual results could differ from these estimates.

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 for doubtful accounts and warranty expenses. 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. Revenues 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 costs expended to date bear to anticipated final total costs, 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. Adjustments to the original estimates of the total contract revenue, total contract costs, or the extent of progress toward completion are often required as work progresses. Such changes and refinements in estimation are reflected in reported results of operations as they occur; if material, the effects of changes in estimates are disclosed in the notes to the consolidated financial statements.

The key assumptions used in the estimate of costs to complete relate to the unit material cost, the quantity of materials to be used, the installation cost and those indirect costs related to contract performance. The estimate of unit material cost is reviewed and updated on a quarterly basis, based on the updated information available in the supply markets. The estimate of material quantity to be used for completion and the installation cost is also reviewed and updated on a quarterly basis, based on the updated information on the progress of project execution. If the supply market conditions or the progress of project execution were different, it is likely that materially different amounts of contract costs would be used in the percentage of completion method of accounting. Thus the uncertainty associated with those estimates may impact our consolidated financial statements. 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

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statements. Claims for additional contract costs are recognized upon a signed change order from the customer.

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 the finished product.
3. Revenue from the rendering of maintenance services is recognized over the service period on a straight-line basis.

In accordance with ASC 605-15, “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 of 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 product 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 the Company’s own products for each project, it is almost impossible to provide revenues for each of the products when the revenue from each project is recognized based on a percentage of completion. More importantly, the revenues from the Company’s own products do not accurately reflect the Company’s overall financial performance. The Company is a system contracting projects provider rather than a product vendor that sells their own products directly or through channels. Therefore, it is not practical to separately disclose the revenues from external customers for each of the 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 ASC 280-10, “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 handling are included in cost of revenue pursuant to ASC 605-45 “Accounting for Shipping and Handling Fees and Costs.”

#### Foreign currency translation

The reporting currency of the Company is the US dollar. The Company’s operating subsidiaries uses their local currency, Renminbi (RMB) and Indian Rupee (INR), 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 consolidated statement of changes in equity.

Asset and liability accounts at December 31, 2010 were translated at 6.59 RMB to \$1.00 and 45.45 INR to \$1.00 as compared with 6.82 RMB to \$1.00 and 46.89 INR to \$1.00 at December 31, 2009, respectively. Equity accounts were stated at their historical rate. The average translation rates of RMB applied to income statement accounts for the year ended December 31, 2010, 2009 and 2008 were 6.78 RMB, 6.82 RMB and 6.94 RMB, respectively. The average translation rate of INR applied to income statement accounts for the year ended December 31, 2010 and 2009 were 45.87 INR and 48.85 INR, respectively. Cash flows are also translated at average translation rates for the period; therefore, amounts reported in the statement of cash flows will not necessarily agree with changes in the corresponding balances in the balance sheets.

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 into any currency trading or hedging transactions, although there is no assurance that the Company will not enter into such transactions in the future.

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## Concentration of risk

Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the PRC, Hong Kong and India. 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. The balances maintained in India are deposited in the branch of DBS Bank (Singapore) Limited, which are fully insured by the Government of Singapore until December 31, 2010. As of December 31, 2010 and December 31, 2009, the Company had deposits (including restricted cash balances) totaling \$37,596,887 and \$40,415,782, respectively, that are not covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

The Company's operations are mainly carried out in the PRC. The revenue recognized from operations in India is immaterial to the Company's consolidated financial statements. Accordingly, the Company's business, financial condition and results of operations may be influenced primarily 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 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 remittances abroad, and rates and methods of taxation, among other things.

The Company has one major customer who represented approximately 41% of the Company's revenues for the year ended December 31, 2010. Accounts receivable from this customer were \$3,815,558 as of December 31, 2010. The Company has one major customer who represented approximately 10% of the Company's revenues for the year ended December 31, 2009. Accounts receivable from this customer were \$97,000 as of December 31, 2009. The Company has one major customer who represents approximately 25% of the Company's revenues for the year ended December 31, 2008.

For the years ended December 31, 2010 two suppliers accounted for approximately 36.2% of the Company's purchases. These two suppliers represented 2.5% of the Company's total accounts payable as of December 31, 2010. There is no supplier accounted more than 10% of the Company's total purchase for the year ended December 31, 2009.

### Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. 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 related to its system contracting projects and product sales customers to guarantee contracts performance. The deposits cannot be drawn or transferred by the Company until the restriction period has expired.

Restricted cash consists of the following:

|                             | December 31,<br>2010 | December 31,<br>2009 |
|-----------------------------|----------------------|----------------------|
| Restricted cash             |                      |                      |
| Product sales               | \$ 4,803,276         | \$ 3,728,599         |
| System contracting projects | 4,666,110            | 1,711,441            |
| Total restricted cash       | 9,469,386            | 5,440,040            |

|                               |              |              |
|-------------------------------|--------------|--------------|
| Restricted cash - non current | (7,533,407)  | (3,602,906)  |
| Restricted cash - current     | \$ 1,935,979 | \$ 1,837,134 |

### Inventories

Inventories are stated at the lower of cost or market, using the weighted average method.

Inventories consist of the following:

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|                  | December 31,<br>2010 | December 31,<br>2009 |
|------------------|----------------------|----------------------|
| Raw materials    | \$ 192,978           | \$ 144,829           |
| Finished goods   | 5,054,289            | 4,574,075            |
| Work in progress | 1,466,181            | 641,616              |
| Total            | \$ 6,713,448         | \$ 5,360,520         |

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, 2010 and 2009, the Company determined no reserves were 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.

We establish an allowance for doubtful accounts based on management's assessment of the collectability of our accounts receivable. A considerable amount of judgment is required in assessing the amount of the allowance. We consider the historical level of credit losses, apply percentages to aged receivable categories, make judgments about the creditworthiness of each customer based on ongoing credit evaluations, and monitor current economic trends that might impact the level of credit losses in the future. If the financial condition of the customers were to deteriorate, resulting in their inability to make payments, a larger allowance may be required.

Additional specific provision is made against accounts receivable to the extent that they are considered to be doubtful. Bad debts are written off against the allowance for doubtful accounts when identified. We do not accrue any interest on accounts receivable. Historically, losses from uncollectible accounts have not deviated from the general allowance estimated by management and no bad debts have been written off directly to the profit and loss. This general provisioning policy has not changed in the past since establishment and management considers that the aforementioned general provisioning policy is adequate and does not expect to change this established policy in the near future. Any changes in the estimates of our general provision policy could have a material effect on our results of operations.

Accounts receivable consist of the following:

|  | December 31,<br>2010 | December 31,<br>2009 |
|--|----------------------|----------------------|
| Accounts receivable:                         |                      |                      |
| System contracting projects                  | \$ 31,930,814        | \$ 23,814,248        |
| Maintenance services                         | 3,817,251            | 3,190,843            |
| Product sales                                | 17,091,283           | 13,988,263           |
| Total accounts receivable                    | 52,839,348           | 40,993,354           |
| Allowance for bad debts                      | (8,153,727)          | (6,539,787)          |
| Accounts receivable, net                     | 44,685,621           | 34,453,567           |
| Accounts receivable - non-current retentions | (2,790,492)          | (3,463,998)          |
| Accounts receivable - current                | \$ 41,895,129        | \$ 30,989,569        |

The activity in the allowance for doubtful accounts for trade accounts receivable for the year ended December 31, 2010 and 2009 is as follows:

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|   | December 31,<br>2010 | December 31,<br>2009 |
|---|----------------------|----------------------|
| Beginning allowance for doubtful accounts | \$ 6,539,787         | \$ 4,370,362         |
| Additions charged to bad debt expense     | 1,894,361            | 2,172,588            |
| Write-off charged against the allowance   | (540,913)            | -                    |
| Foreign currency translation adjustment   | 260,492              | (3,163)              |
| Ending allowance for doubtful accounts    | \$ 8,153,727         | \$ 6,539,787         |

Retentions held by customers for system contracting projects included in the Company's accounts receivable are as follows:

|                  | December 31,<br>2010 | December 31,<br>2009 |
|------------------|----------------------|----------------------|
| Retentions       |                      |                      |
| Current          | \$ 6,130,574         | \$ 2,967,248         |
| Non-current      | 2,790,492            | 3,463,998            |
| Total retentions | \$ 8,921,066         | \$ 6,431,246         |

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.

As of December 31, 2010, the Company believes that there was 14.7% percentage of accounts receivable would be collected in more than one year, based on our historical collection pattern.

#### 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.

Costs and estimated earnings in excess of billings consists of the following:

|  | December 31,<br>2010 | December 31,<br>2009 |
|--|----------------------|----------------------|
| Contract costs incurred plus recognized profits less recognized losses to date | \$ 130,434,619       | \$ 116,754,059       |
| Less: progress billings  | (89,774,606)         | (80,191,486)         |
| Costs and estimated earnings in excess of billings                             | \$ 40,660,013        | \$ 36,562,573        |

The Company believes that there was some portion of costs and estimated earnings in excess of billings would be collected in more than one year, based on our historical billing and collection pattern. Currently, we are actively evaluating all the possible estimation methods in order to best estimate the amount to be collected in more than one year. We expect to disclose the estimated amount to be collected in more than one year with our estimation method as soon as we determined a reasonable method.

#### 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.

Billings in excess of costs and estimated earnings consists of the following:

December 31,    December 31,

|  | 2010          | 2009          |
|--|---------------|---------------|
| Progress billings  | \$ 16,126,195 | \$ 14,679,369 |
| Less: contract costs incurred plus recognized profits less recognized losses to date | (13,253,489)  | (16,109,368)  |
| Billings in excess of costs and estimated earnings                                   | \$ 2,872,706  | \$ 1,429,999  |

#### 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 a 5% residual value. Depreciation expense amounted to \$836,537, \$766,473, and \$728,080 for the years ended December 31, 2010, 2009 and 2008, respectively.

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Estimated useful lives of the assets are as follows:

|                            | Useful<br>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. Interest incurred during construction is capitalized into construction in progress. All other interest is expensed as incurred.

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 consolidated statements of income. Maintenance, repairs and minor renewals are charged directly to expense as incurred. Major additions and betterments to buildings and equipment are capitalized.

Plant and equipment consists of the following:

|                               | December 31,<br>2010 | December 31,<br>2009 |
|-------------------------------|----------------------|----------------------|
| Buildings and improvements    | \$ 7,258,465         | \$ 6,439,015         |
| Transportation equipment      | 3,963,302            | 3,307,236            |
| Machinery                     | 901,655              | 900,781              |
| Office equipment              | 1,083,512            | 1,348,261            |
| Furniture                     | 126,032              | 165,736              |
| Total depreciable assets      | 13,332,966           | 12,161,029           |
| Less accumulated depreciation | (3,988,332)          | (3,875,487)          |
| Construction in progress      | 296,485              | 331,979              |
| Plant and equipment, net      | \$ 9,641,119         | \$ 8,617,521         |

#### Intangible assets

Land use rights - All land in the PRC 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 the rights to manufacture two fire protection products and the costs of these rights are being amortized over ten years using the straight-line method.

Intangible assets consist of the following:

|                          | December 31,<br>2010 | December 31,<br>2009 |
|--------------------------|----------------------|----------------------|
| Land use rights          | \$ 770,789           | \$ 770,789           |
| Technology rights        | 608,745              | 608,745              |
| Accumulated amortization | (393,891)            | (338,378)            |
| Balance                  | \$ 985,643           | \$ 1,041,156         |

Amortization expense amounted to \$75,382, \$75,284 and \$75,041 for the years ended December 31, 2010, 2009 and 2008, respectively.

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### Impairment of long-lived assets

The Company assesses the impairment of long-lived assets, which include identifiable intangible assets, and property and equipment, at least annually or more often whenever events or changes in circumstances indicate that the carrying value of the long lived assets may not be recoverable. Changes in the underlying business could adversely affect the fair value and recoverability of these assets. Important factors which could require an impairment review include: (i) underperformance relative to expected historical or projected future operating results; (ii) changes in the manner of use of the assets or the strategy for our overall business; (iii) negative industry or economic trends; (iv) our enterprise fair value relative to net book value.

Our impairment evaluation of identifiable intangible assets and property and equipment includes an analysis of estimated future undiscounted net cash flows expected to be generated by the assets over their remaining estimated useful lives. If the estimated future undiscounted net cash flows are insufficient to recover the carrying value of the assets over the remaining estimated useful lives, the Company records an impairment loss in the amount by which the carrying value of the assets exceeds the fair value. The Company determines fair value based on either market quotes, if available, or discounted cash flows using a discount rate commensurate with the risk inherent in our current business model for the specific asset being valued. Major factors that influence our cash flow analysis are our estimates for future revenue and expenses associated with the use of the asset. Different estimates could have a significant impact on the results of our evaluation. If, as a result of our analysis, the Company determines that our amortizable intangible assets or other long-lived assets have been impaired, the Company will recognize an impairment loss in the period in which the impairment is determined. Any such impairment charge could be significant and could have a material negative effect on our results of operations. As of December 31, 2010, the Company expects these assets to be fully recoverable.

### Backlog

#### System Contracting Projects

The following schedule shows a reconciliation of backlog representing the amount of revenue the company expects to realize from work to be performed on uncompleted contracts in progress at December 31, 2010 and from contractual agreements on which work has not yet begun.

|  |                |
|--|----------------|
| Contract revenue on uncompleted contracts at December 31, 2009   | \$ 20,706,885  |
| Contract adjustments (change orders)   | 2,322,785      |
| Contract revenue for new contracts for the year ended December 31, 2010  | 110,275,906    |
| Bids awarded and pending execution of contracts for the year ended December 31, 2010   | 32,450,706     |
| Less: Contract revenue earned for the year ended December 31, 2010 excluded the effect of miscellaneous sales tax of \$1,398,520 | (60,942,610)   |
| Effect of exchange rate changes  | 2,177,001      |
| Backlog at December 31, 2010   | \$ 106,990,673 |

In addition, the Company entered into additional system contracting project contracts with revenues of \$12,575,317 between January 1, 2011 and March 16, 2011.

### Products

As of December 31, 2010, the backlog of unshipped and uninspected orders was \$43,080,646. In addition, the Company entered into additional product sales contracts with revenues of \$2,374,785 between January 1, 2011 and March 16, 2011.

Maintenance Service

As of December 31, 2010, the future revenue under existing service agreements amounted to \$1,290,995.

Research and development

Research and development expenses include salaries, consultant fees, supplies and materials, as well as costs related to other overheads such as depreciation, facilities, utilities and other departmental expenses. The costs that the Company incurs 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.

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## 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 to the customer. The Company maintains a provision for potential warranty costs on these products for one year. This provision represents management's assessment of the Company's history of warranty costs while incorporating estimates by the quality review staff of the potential product failure rates. The Company records a warranty obligation in selling expense at the time revenue is recognized. As of December 31, 2010, 2009 and 2008, the Company recorded \$383,744, \$582,595 and \$518,940, respectively, as a provision for estimated warranty claims.

## Fair value of financial instruments

ASC 825-10-50, "Disclosures about Fair Value of Financial Instruments," defines financial instruments and requires fair value disclosures for those instruments. ASC 820-10, "Fair Value Measurements," defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. 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.

The carrying amounts reported in the balance sheets for receivables and payables 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.

Investments in joint ventures are also a financial instrument. The Company invested \$172,938 (RMB 1,140,000) in Hubei Shou An Changjiang Fire Protection Co., Ltd for a 19% equity interest, invested \$321,186 (RMB 2,117,246) in Tianxiao Fire Safety Equipment Co., Ltd. for 16.7% equity interest and \$2,710 (INR 125,000) in Sureland India for a 5% equity interest. Total investments as of December 31, 2010 amounted to \$496,834. There is no quoted or observable market price for the fair value of similar long term investments in joint ventures. The Company believes that the cost of the capital contributed to these joint ventures is a reasonable approximation of their fair values.

During September 2009, the Company sold its 5% interest in King Galaxy Investment Limited at cost to Mr. Wei Jing, who is the controlling shareholder of King Galaxy Investment Limited, for cash consideration of \$1.0 million. The proceeds of \$1.0 million were fully received by the Company as of December 31, 2009. King Galaxy through its wholly owned subsidiary, China Alliance Security Holdings Company Limited, owns 100% of Wan Sent (China) Technology Co., Ltd.

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 ASC 820-10.

## Income taxes

The Company reports income taxes pursuant to ASC 740, "Accounting for Income Taxes" and ASC 740-10, "Accounting for Uncertainty in Income Taxes" (formerly "FIN 48"). ASC 740 requires the recognition of deferred income tax

liabilities and assets for the expected future tax consequences of temporary differences between the income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consists of taxes currently due plus deferred taxes. Deferred tax assets amounted to \$85,678, \$84,126 and \$0 as of December 31, 2010, 2009 and 2008, respectively, and are included in prepayment and deferred expenses in the accompanying consolidated balance sheets.

Under ASC 740-10, 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

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benefit is recorded. ASC 740-10 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the years ended December 31, 2010, 2009 and 2008.

The Company's operations are subject to income and transaction taxes in the United States, the PRC and the India 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 principle, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilized. Deferred tax is calculated using enacted 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.

#### 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. All of our PRC subsidiaries' VAT is subject to a 17% rate except Beijing Hua An. To support the development of the software industry, the Chinese government has instituted policies to rebate VAT charged for software certified by the government up to 14%. As a result, Beijing Hua An is paying VAT at an effective rate of 3% for their intercompany software sales.

VAT on sales and VAT on purchases amounted to \$10,023,777 and \$5,045,059 for the year ended December 31, 2010, \$9,745,786 and \$4,935,357 for the year ended December 31, 2009, and \$6,941,766 and \$5,183,036 for the year ended December 31, 2008, 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 follows ASC 718, "Accounting for Stock-Based Compensation," 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 granted to non-employees has been determined in accordance with ASC 718 and ASC 505-50, "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.

ASC 718 requires that all share-based compensation be recognized as an expense in the consolidated financial statements and that such cost be measured at the fair value of the award and requires compensation cost to reflect estimated forfeitures. The determination of the fair value of share-based compensation awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including our expected stock price volatility over the term of the awards, actual and projected share option exercise behaviors, risk-free interest rates and expected dividends. The volatility of the Company's common stock was estimated by management based on the historical volatility of our common stock, the risk free interest rate was based on Treasury Constant Maturity Rates published by the U.S. Federal Reserve for periods applicable to the expected life of the share option, the expected dividend yield was based on the Company's current and expected dividend policy, and

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the projected share option exercise behaviors is based on one-half of the sum of the vesting period and the contractual life of each share option. This is the same as assuming that the options are exercised at the mid-point between the vesting date and expiration date.

#### Recently issued accounting pronouncements

In January 2010, FASB issued ASU No. 2010-01- "Accounting for Distributions to Shareholders with Components of Stock and Cash." The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – "Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification." The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – "Improving Disclosures about Fair Value Measurements." This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update 2010-09, "Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements," or ASU 2010-09. ASU 2010-09 primarily rescinds the requirement that, for listed companies, financial statements clearly disclose the date through which subsequent events have been evaluated. Subsequent events must still be evaluated through the date of financial statement

issuance; however, the disclosure requirement has been removed to avoid conflicts with other SEC guidelines. ASU 2010-09 was effective immediately upon issuance and was adopted in February 2010.

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In April 2010, the FASB issued Accounting Standards Update 2010-13, “Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades,” or ASU 2010-13. This Update provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in currency of a market in which a substantial porting of the entity’s equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company’s consolidated financial statements.

In April 2010, the FASB issued Accounting Standard Update 2010-17, “Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition” or ASU 2010-17. This Update provides guidance on the recognition of revenue under the milestone method, which allows a vendor to adopt an accounting policy to recognize all of the arrangement consideration that is contingent on the achievement of a substantive milestone (milestone consideration) in the period the milestone is achieved. The pronouncement is effective on a prospective basis for milestones achieved in fiscal years and interim periods within those years, beginning on or after June 15, 2010. Adoption of this ASU did not have material impact on the Company’s consolidated financial statements.

In July 2010, FASB issued Accounting Standard Update 2010-20, “Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses” or ASU 2010-20. This Update provides enhanced disclosures which are designed to assist financial statement users in assessing an entity’s credit risk exposure and in evaluating the adequacy of an entity’s allowance for credit losses. Public entities must apply the disclosure requirements applicable to period-end balances beginning with the first interim or annual reporting period ending on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company’s consolidated financial statements.

In September 2010, FASB issued Accounting Standard Update 2010-25, “Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans” or ASU 2010-25. The ASU clarifies how loans to participants should be classified and measured by defined contribution plans and how IFRS compare to these provisions. The amendments in this update are effective for fiscal years ending after December 15 2010. Adoption of this ASU did not have material impact on the Company’s consolidated financial statements.

In December 2010, the FASB issued Accounting Standard Update 2010-28, Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU modified Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. For public entities, the amendments in the ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Adoption of this ASU did not have material impact on the Company’s consolidated financial statements.

In December 2010, the FASB issued Accounting Standard Update 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. This ASU specifies that, if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU 2010-29 is effective prospectively for business combinations where the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company’s consolidated financial statements.

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.

Note 3 - Earnings per share

The Company reports earnings per share in accordance with the provisions of ASC 260-10, "Earnings per Share." ASC260-10 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 are 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 year ended December 31:

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|   | 2010          | 2009          |
|---|---------------|---------------|
| Net income for earnings per share                               | \$ 15,437,935 | \$ 24,414,836 |
| Weighted average shares used in basic computation               | 27,618,465    | 27,590,523    |
| Dilutive effect of stock options, restricted stock and warrants | 1,949,964     | 721,432       |
| Weighted average shares used in diluted computation             | 29,568,429    | 28,311,955    |
| Earnings per share:   |               |               |
| Basic   | \$ 0.56       | \$ 0.88       |
| Diluted   | \$ 0.52       | \$ 0.86       |

As of December 31, 2010 and 2009, all outstanding stock options and restricted stocks were included in the calculation of diluted earnings per share.

#### Note 4 - Related party transactions

The Company has receivables from Hubei Shou An Changjiang Fire Protection Co., Ltd. (“Hubei Shou An”), in which the Company has a 19% ownership interest. The accounts receivable due from Hubei Shou An was \$160,731 and \$155,433 as of December 31, 2010 and 2009, respectively, which resulted from product sales of \$57,016 and \$41,045 for the years ended December 31, 2010 and 2009, respectively.. This amount is expected to be repaid by December 31, 2011 in cash.

In addition, the Company has other receivables from Hubei Shou An in the amounts of \$234,042 and \$396,359 as of December 31, 2010 and December 31, 2009, respectively. This balance was for operating capital in Hubei Shou An and is expected to be repaid by December 31, 2011 in cash.

The Company has prepayments to Tianjin Tianxiao Fire Safety Equipment Co., Ltd., in which the Company has a 16.7% ownership interest. The prepayment to Tianjin Tianxiao Fire Safety Equipment Co., Ltd. was \$1,603,123 as of December 31, 2010 and accounts payable were \$272,994 as of December 31, 2009, resulting from product purchases of \$4,465,084 and \$1,465,842 for the years ended December 31, 2010 and 2009, respectively, after the restructuring of 83.3% ownership interest in Tianxiao Equipment.

Advance payments to Sureland India, in which the Company has a 5.0% ownership interest, were \$450,170 and \$103,174 as of December 31, 2010 and 2009, respectively. This balance was for the advance payment to Sureland India for the delivery of future services.

#### Note 5 - Notes receivable

Notes receivable represents trade accounts receivable due from various customers where the customers’ bank or a customer with a AAA rating has guaranteed the payment of the receivable. These amount are non-interest bearing and are normally paid within three to six months. The Company has the ability to submit a 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 \$14,428,802 and \$4,274,268 as of December 31, 2010 and 2009, respectively, of which \$6,826,500 and \$0 as of December 31, 2010 and 2009, respectively, are corporate notes receivable that are guaranteed by a customer with a AAA rating.

#### 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 to 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 \$10,281,292 and \$3,397,358 as of December 31, 2010 and December 31, 2009, respectively.

Note 7 - Investment in joint ventures

During the second quarter of 2007, the Company invested \$172,938 (RMB1,140,000) 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.

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As of December 31, 2009, the Company held an investment of \$321,186 (RMB2,117,246) for a 16.7% interest in Tianjin Tianxiao Fire Safety Equipment Co., Ltd. as a non-controlling interest holder. The investment is recorded under the cost accounting method at fair value at the deconsolidation date.

In January 2010, the company invested \$2,710 (INR125,000) for a 5% interest in Sureland India as a non-controlling interest holder. The investment is recorded under the cost accounting method.

#### Note 8 - Customer deposits

Customer deposits represent amounts advanced by customers on products order, maintenance services deposits and system contracting projects deposits. The product or service normally is shipped or performed within nine months after receipt of the advance payment and the related sale is recognized in accordance with the Company's revenue recognition policy. These advance payments are applied to the invoices when the Company bills the customer based on the progression of the projects. As of December 31, 2010 and December 31, 2009, customer deposits amounted to \$3,023,329 and \$2,182,790, respectively.

#### Note 9 - Accrued liabilities

Accrued liabilities represent subcontractors' expenses incurred as of the balance sheet date for system contracting projects. Accrued liabilities also represent an accrued estimation of warranty expenses. As of December 31, 2010 and December 31, 2009, accrued liabilities amounted to \$19,737,906 and \$13,841,300, respectively.

#### Note 10 - Income taxes

##### Local PRC Income Tax

Starting from January 1, 2008, all of the Company's Chinese subsidiaries are subject to a 25% income tax rate according to the Income Tax Laws of the PRC. According to the PRC's central government policy, certain new technologies and/or high technology companies will enjoy a preferential tax rate of 15%, instead of 25%. Beijing Hua An qualifies for the preferential tax treatment. Sureland Industrial, Sureland Equipment and Beijing Hua An receive a 50% income tax reduction for three years beginning in January 2009 due to the fact that they are located in a specially designated region.

##### India Project Office Income Tax

The Company's operation in India is managed on a project basis and projects are conducted under the name of CFPG or Sureland Industrial as a foreign enterprise. Under the India Income Tax Act, the Company's projects are generally subject to an income tax at an effective rate of 40% on income reported in the statutory financial statements after appropriate tax adjustments in accordance with Indian tax regulations.

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  | -%                   | 25.0%                     |

The Company's subsidiaries are paying the following tax rate for the year ended December 31, 2009:

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| Subsidiaries        | Income tax exemption | Effective income tax rate |
|---------------------|----------------------|---------------------------|
| Sureland Industrial | 12.5%                | 12.5%                     |
| Sureland Equipment  | 12.5%                | 12.5%                     |
| Beijing Hua An      | 17.5%                | 7.5%                      |
| Tianxiao Equipment  | -%                   | 25.0%                     |
| Shian Kexin         | -%                   | 25.0%                     |
| Shanyang Hongshida  | -%                   | 25.0%                     |

The Company's subsidiaries are paying the following tax rate for the year ended December 31, 2010

| Subsidiaries         | Income tax exemption | Effective income tax rate |
|----------------------|----------------------|---------------------------|
| Sureland Industrial  | 12.5%                | 12.5%                     |
| Sureland Equipment   | 12.5%                | 12.5%                     |
| Beijing Hua An       | 17.5%                | 7.5%                      |
| Shian Kexin          | -%                   | 25.0%                     |
| Zeetech              | -%                   | 40.0%                     |
| India Project Office | -%                   | 40.0%                     |
| Shanyang Hongshida   | -%                   | 25.0%                     |

The provision (credit) for income taxes amounted to \$3,210,378, \$4,165,548 and \$47,423 for the years ended December 31, 2010, 2009 and 2008, respectively.

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

|                                      | 2010     | 2009   | 2008   |
|--------------------------------------|----------|--------|--------|
| 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     | 25.0   | 25.0   |
| China income tax exemption           | (13.03.) | (15.5) | (24.8) |
| Permanent Differences (China)(1)     | 1.12     | 1.02   | -      |
| Other item (2)                       | 4.21     | 4.08   | -      |
| Effective income tax rates           | 17.3%    | 14.6%  | 0.2%   |

(1)The 1.12% represents \$1,595,194 of bad debt provisions and \$208,114 of meals and entertainment expenses incurred by Sureland Industrial, Sureland Equipment, and Beijing Hua An that are not deductible in PRC for the year ending December 31, 2010. These non-deductible expenses were offset by \$983,279, which is a 50% additional deduction allowed in PRC for Research and Development expenses at Sureland Industrial. The 1.02% represents \$2,089,411 of bad debt provisions and \$129,036 of meals and entertainment expenses incurred by Sureland Industrial, Sureland Equipment, and Beijing Hua An that are not deductible in PRC for the year ending December 31, 2009. These non-deductible expenses were offset by \$815,717 which is a 50% additional deduction allowed by PRC for Research and Development expenses at Sureland Industrial. The 0% represents all expenses incurred in Sureland Industrial, Sureland Equipment, and Beijing Hua An that are not deductible in PRC for the year ending December 31, 2008, since most of the revenue generated in those Chinese entities were exempted for income tax during fiscal year of 2008.

(2) The 4.21%, 4.08% and 0% represents \$5,080,228, \$2,316,409 and \$930,683 in expenses incurred by CFSG and CFPG that are not deductible in PRC for the year ended December 31, 2010, 2009 and 2008, respectively.

The estimated tax savings as a result of PRC income tax exemption for the years ended December 31, 2010, 2009 and 2008 amounted to \$3,109,126, \$4,412,017 and \$6,382,286, respectively. The net effect on basic and diluted earnings per share if the income tax had been applied would decrease basic and diluted earnings per share for the years ended December 31, 2010, 2009 and 2008 by \$0.11, \$0.14 and \$0.23, respectively.

China Fire & Security Group, Inc. , the parent company, is incorporated in the United States and incurred net operating losses of \$0 for income tax purposes for the year ended December 31, 2010. The estimated net operating loss carry forwards at December 31, 2010 for United States income taxes amounted to \$1,079,324 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized, from 2024 through 2030. 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

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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 years ended December 31, 2010 and 2009 was \$0 and the accumulated valuation allowance as of December 31, 2010 and 2009 amounted to \$366,970. Management reviews this valuation allowance periodically and makes adjustments as warranted.

The Company has cumulative undistributed earnings of foreign subsidiaries of approximately \$84.0 million as of December 31, 2010, which is included in the consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings, nor is it practicable to estimate the amount of income taxes that would have to be provided if the Company concluded that such earnings will be remitted in the future.

#### Taxes payable

Taxes payable consisted of the following:

|                      | December 31,<br>2010 | December 31,<br>2009 |
|----------------------|----------------------|----------------------|
| VAT taxes payable    | \$ 6,887,213         | \$ 4,636,786         |
| Income taxes payable | 1,284,469            | 2,936,047            |
| Sales taxes          | 1,120,446            | 1,358,372            |
| Other taxes payable  | 124,701              | 71,265               |
| <b>Total</b>         | <b>\$ 9,416,829</b>  | <b>\$ 9,002,470</b>  |

#### 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 2010 and 2009. The contributions are charged to the consolidated 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 \$481,538, \$416,857 and \$250,720 for the years ended December 31, 2010, 2009 and 2008, respectively.

#### Note 12 - Statutory reserves

The laws and regulations of the PRC 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 a 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 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. 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.

Because the surplus reserve fund already totals 50% of Sureland Industrial, Sureland Equipment, and Beijing Hua An's registered capital, the Company did not reserve any surplus reserve fund at the end of December 31, 2010 for these subsidiaries. As of December 31, 2010, the remaining reserve required for Shian Kexin and Shenyang Hongshida to fulfill the 50% registered capital requirement totaled \$758,500.

Enterprise fund

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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, 2010, 2009 and 2008.

#### Note 13 - Warrants

In 2008, a total of 45,000 warrants were converted into 29,700 shares of common stock by the warrant holders using the cashless exercise option.

In June 2009, 10,000 warrants were converted into 6,682 shares of common stock by the warrant holders using the cashless exercise option.

At December 31, 2010 and 2009, the Company had no warrants outstanding.

#### Note 14 - Options issued to employees

On December 31, 2008, pursuant to the Company's 2008 Omnibus Long-term Incentive Plan, the Company's Board of Directors authorized the issuance of 1,000,000 share options for its employees, including 800,000 options issued to executive officers. The options vest evenly each quarter over the following four years, starting from the first quarter of 2009. The Company used the Black Scholes Model to value the options at the time they were issued, based on the exercise price of \$6.81, which was the closing price of the Company's stock on December 31, 2008 and using risk-free rates of 0.875%, 1.125%, 1.313% and 1.5% and volatility of 86% that was estimated by analyzing the trading history of the Company's stock. Because the Company did not have historical exercise history, the Company used the simplified method to estimate the expected life of the options, which is equal to the midpoint between the vesting date and expiration date of the options. The 1,000,000 employee options had a grant date fair value of \$3,863,606. 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 years ended December 31, 2010, 2009, and 2008 was \$980,195, \$980,196 and \$40,152, respectively. As of December 31, 2010, approximately \$1.93 million of estimated expense related to un-vested stock-based awards has yet to be recognized and will be recognized over the employee's remaining service period of approximately 1.97 years.

During the year ended December 31, 2010, 10,393 options were converted into 10,393 shares of common stock using a cash exercise. There were 1,765,607 options outstanding as of December 31, 2010. As of December 31, 2010, the employee has not contributed the exercise contribution amount of \$27,570.

The Company has stock options as follows:

|                                | Options<br>Outstanding | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|------------------------|--|---------------------------------|
| 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                     |
| Granted                        | 1,000,000              | 6.81                                     | -                               |
| Forfeited                      | -                      | -  | -                               |
| Exercised                      | (3,500 )               | 4.51                                     | -                               |

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|                                |           |        |              |
|--------------------------------|-----------|--------|--------------|
| Outstanding, December 31, 2009 | 1,776,000 | \$4.45 | \$16,120,860 |
| Granted                        | -         | -      | -            |
| Forfeited                      | -         | -      | -            |
| Exercised                      | (10,393 ) | 2.65   | -            |
| Outstanding, December 31, 2010 | 1,765,607 | \$4.46 | \$3,719,188  |

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Following is a summary of the status of options outstanding at December 31, 2010:

| Outstanding Options |                |                                    | Exercisable Options |                |                                    |
|---------------------|----------------|------------------------------------|---------------------|----------------|------------------------------------|
| Number of Options   | Exercise Price | Average Remaining Contractual Life | Number of Options   | Exercise Price | Average Remaining Contractual Life |
| 742,229             | \$ 1.25        | 5.50                               | 742,229             | \$ 1.25        | 5.50                               |
| 6,000               | \$ 4.51        | 1.33                               | 6,000               | \$ 4.51        | 1.33                               |
| 20,000              | \$ 6.70        | 1.50                               | 17,500              | \$ 6.70        | 1.50                               |
| 997,378             | \$ 6.81        | 3.00                               | 497,378             | \$ 6.81        | 3.00                               |
| 1,765,651           |                |                                    | 1,263,107           |                |                                    |

#### Note 15 - Restricted stock issued to employees

On December 1, 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 restricted stock for its employee, including 285,000 shares of restricted stock issued to executive officers. The restricted stocks will vest evenly each year over the following four years, starting from December 1, 2009. The Company used the closing price of the Company's common stock at the time the restricted stock grants were made, based on the closing price of \$12.65, which was the closing price of the Company's stock on November 30, 2009.

The 1,000,000 shares of employee restricted stock had a fair value of \$12,650,000. The related compensation expense is recognized on a straight-line basis over the four year vesting period.

The total restricted stock compensation expense recognized for the years ended December 31, 2010, 2009 and 2008 was \$3,162,500, \$263,542 and \$0, respectively.

As of December 1, 2010, 250,000 shares of the restricted stock are vested and issued to the employees and executive officers accordingly.

#### Note 16 - Commitments and Contingencies

##### Commitments

As described in Note 1, Shenyang Hongshida has a registered capital of \$1,497,000, of which \$748,500 has been invested as of December 31, 2010. The remaining \$748,500 is scheduled to be injected within two years of June 1, 2009, the date of the Company's by-laws.

##### Contingencies

From time to time, the Company is involved in legal matters arising in the ordinary course of business. Management currently is not aware of any legal matters or pending litigation which would have a significant effect on the Company's consolidated financial statements

#### Note 17 – Restructuring of Tianxiao Equipment

On July 3, 2009, Sureland Industrial signed an agreement to transfer 83.3% ownership in Tianxiao Equipment to Tianjin Fire Protection Equipment Co., Ltd. for consideration approximately equal to the net assets of Tianxiao Equipment as of June 30, 2009, which was approximately \$1.6 million (RMB 10.6 million). A loss of \$913 was

recognized in this transaction. The proceeds of \$1.6 million have been fully received by the Company as of December 31, 2009.

After the restructuring, Sureland Industrial became a minority shareholder, with a 16.7% ownership in Tianxiao Equipment. The investment is recorded under the cost accounting method. Sureland Industrial is continuing to purchase fire safety and protection

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products through Tiaoxiao Equipment, which does not require the classification of the deconsolidation of Tianxiao Equipment as a discontinued operation in accordance with ASC 205-20-55.

Note 18 – Quarterly financial information (unaudited)

For the fiscal years ended December 31, 2010 and 2009, the Company has unaudited quarterly financial data as following:

| Year Ended<br>December 31, 2010                    | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter | Full Year    |
|--|------------------|-------------------|------------------|-------------------|--------------|
| Revenues   | \$20,943,726     | \$22,833,431      | \$24,817,588     | \$11,381,937      | \$79,976,682 |
| Gross profit                                       | 11,632,156       | 12,395,052        | 12,541,575       | 4,709,659         | 41,278,442   |
| Net income attributable to controlling<br>interest | 5,247,225        | 6,333,660         | 5,934,770        | (2,077,720 )      | 15,437,935   |
| Basic EPS  | 0.19             | 0.23              | 0.22             | (0.07 )           | 0.56         |
| Diluted EPS  | 0.19             | 0.22              | 0.20             | (0.07 )           | 0.52         |

| Year Ended<br>December 31, 2009                    | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter | Full Year    |
|--|------------------|-------------------|------------------|-------------------|--------------|
| Revenues   | \$16,712,211     | \$22,731,868      | \$24,816,429     | \$16,920,690      | \$81,181,198 |
| Gross profit                                       | 10,296,759       | 14,500,571        | 13,999,311       | 8,256,635         | 47,053,276   |
| Net income attributable to controlling<br>interest | 5,645,603        | 8,336,222         | 7,553,941        | 2,879,070         | 24,414,836   |
| Basic EPS  | 0.20             | 0.30              | 0.27             | 0.11              | 0.88         |
| Diluted EPS  | 0.20             | 0.29              | 0.27             | 0.10              | 0.86         |

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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**          | Registration Rights Agreement dated October 27, 2006 between the Company and named Investors  |
| 4.2**          | Registration 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  |
| 4.7            | 2008 Omnibus Long Term Incentive Plan (Incorporated by reference from Exhibit 4.1 of Form S-8 filed on December 2, 2009)  |
| 4.8            | Form Stock Option Agreement (Incorporated by reference from Exhibit 4.2 of Form S-8 filed on December 2, 2009)  |
| 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 |

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| 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   |
| 16.1           | Letter of Moore Stephens Wurth Frazer and Torbet, LLP dated January 7, 2010. (Incorporated by reference from Exhibit 16.1 of Form 8-K filed January 7, 2010.) |
| 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

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

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