

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC.  
Form 10-Q  
July 25, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10 Q**  
(Mark One)

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

For the quarterly period ended: June 30, 2011

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-33774

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**98-0509431**

(I.R.S. Empl. Ident. No.)

**13/F, Shenzhen Special Zone Press Tower, Shennan Road  
Futian District, Shenzhen, China 518034**

(Address of principal executive offices, Zip Code)

**(86) 755-8351-0888**

(Registrant's telephone number, including area code)

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 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	<input type="checkbox"/>	Accelerated Filer	<input checked="" type="checkbox"/>
Non-Accelerated Filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(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 Exchange Act).

Yes  No

The number of shares outstanding of each of the issuer's classes of common equity, as of July 21, 2011 is as follows:

<u>Class of Securities</u>	<u>Shares Outstanding</u>
Common Stock, \$0.0001 par value	89,703,773

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**PART I**  
**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS.**

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**AS OF JUNE 30, 2011 (UNAUDITED) AND DECEMBER 31, 2010**

Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)

**ASSETS**

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Cash and cash equivalents	\$ 144,205	\$ 65,626
Restricted cash	22,472	--
Accounts receivable, net	491,369	433,986
Inventories, net	43,101	59,368
Prepayments and deposits	168,589	56,241
Advances to suppliers and subcontractors	154,760	88,360
Other receivables	48,568	47,116
Total current assets	1,073,064	750,697
Deposits paid for business acquisitions, properties and intangible assets	132,753	146,243
Plant and equipment, net	77,321	75,294
Land use rights, net	8,042	7,896
Intangible assets, net	45,799	48,692
Goodwill	79,519	79,516
Deferred financing costs, net	2,143	2,684
<b>TOTAL ASSETS</b>	<b>\$ 1,418,641</b>	<b>\$ 1,111,022</b>

Continued

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**  
**AS OF JUNE 30, 2011 (UNAUDITED) AND DECEMBER 31, 2010**

Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)

**LIABILITIES AND EQUITY**

	June 30, 2011	December 31, 2010
<b>CURRENT LIABILITIES</b>		
Notes payable short term	\$ 191,014	\$ 196,329
Obligations under product financing arrangements short term	5,512	6,687
Guaranteed senior unsecured notes payable short term	22,168	37,408
Accounts and bills payable	77,464	32,240
Accrued expenses	60,919	49,421
Advances from customers	18,722	15,216
Taxes payable	29,438	28,648
Payable for acquisition of businesses	3,763	3,763
Deferred income	2,806	3,201
Total current liabilities	411,806	372,913
<b>LONG TERM LIABILITIES</b>		
Notes payable long term	299,945	60,570
Obligation under product financing arrangements long term	3,810	6,474
Guaranteed senior unsecured notes payable long term	3,324	6,580
Net deferred tax liabilities	676	282
Total liabilities	719,561	446,819
<b>EQUITY</b>		
Preferred stock, \$0.0001 par value; 10,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$0.0001 par value; 290,000,000 shares authorized 89,703,773 (June 30, 2011) and 89,521,115 (December 31, 2010) shares issued and outstanding	9	9
Additional paid-in capital	384,981	374,417
Retained earnings	251,016	243,371
Statutory surplus reserve fund	804	804
Accumulated other comprehensive income	62,287	45,619
Total equity of the Company	699,097	664,220
Noncontrolling interest	(17)	(17)
Total equity	699,080	664,203
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 1,418,641</b>	<b>\$ 1,111,022</b>

See accompanying notes to condensed consolidated financial statements

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2011 AND 2010**

Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	<u>(Unaudited)</u>	<u>(Unaudited)</u>	<u>(Unaudited)</u>	<u>(Unaudited)</u>
<b>Revenues</b>	\$ 156,339	\$ 168,354	\$ 255,393	\$ 288,544
Cost of goods sold (including depreciation and amortization for the three and six months ended June 30, 2011 and 2010 of \$254, \$513, \$248 and \$502, respectively)	114,331	124,994	181,898	216,205
<b>Gross profit</b>	42,008	43,360	73,495	72,339
Selling and marketing	3,116	3,131	5,812	5,845
General and administrative (including non-cash employee compensation for the three and six months ended June 30, 2011 and 2010 of \$5,017, \$10,564, \$5,055 and \$13,381, respectively)	21,274	12,670	38,972	28,992
Depreciation and amortization	2,971	3,005	5,939	5,985
<b>Income from operations</b>	14,647	24,554	22,772	31,517
Interest income	222	53	363	131
Interest expense	(6,436)	(3,064)	(11,550)	(5,359)
Other income, net	715	394	1,311	640
<b>Income before income taxes</b>	9,148	21,937	12,896	26,929
Income taxes	(3,182)	(4,130)	(5,251)	(5,847)
<b>Net income</b>	5,966	17,807	7,645	21,082
Add: Net income attributable to the noncontrolling interest	--	(4)	--	(2)
<b>Net income attributable to the Company</b>	5,966	17,803	7,645	21,080
Foreign currency translation gain	9,837	3,198	16,668	3,322
<b>Comprehensive income attributable to the Company</b>	15,803	21,001	24,313	24,402
Comprehensive income attributable to the noncontrolling interest	--	4	--	2
<b>COMPREHENSIVE INCOME</b>	\$ 15,803	\$ 21,005	\$ 24,313	\$ 24,404
<b>NET INCOME PER SHARE ATTRIBUTABLE TO THE COMPANY'S COMMON SHAREHOLDERS</b>				

BASIC	\$	0.07	\$	0.25	\$	0.09	\$	0.31
DILUTED	\$	0.07	\$	0.23	\$	0.09	\$	0.29

**WEIGHTED AVERAGE**

**NUMBER OF SHARES**

**OUTSTANDING**

BASIC	84,833,000	71,480,000	84,835,000	67,993,000
DILUTED	89,709,000	76,006,000	89,709,000	72,209,000

See accompanying notes to condensed consolidated financial statements

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2011 (UNAUDITED)**

Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)

	The Company's Shareholders							Total Equity
	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Statutory Surplus Reserve Fund	Non- Controlling Interest	
<b>BALANCE AT JANUARY 1, 2011</b>	89,521,115	\$ 9	\$ 374,417	\$ 243,371	\$ 45,619	\$ 804	(17)	\$ 664,203
Issuance of restricted stock under Equity Incentive Plan (net of forfeited and retired shares) and recognition of stock-based compensation	182,658	--	10,564	--	--	--	--	10,564
Foreign currency translation gain	--	--	--	--	16,668	--	--	16,668
Net income for the period	--	--	--	7,645	--	--	--	7,645
<b>BALANCE AT JUNE 30, 2011</b>	89,703,773	\$ 9	\$ 384,981	\$ 251,016	\$ 62,287	\$ 804	(17)	\$ 699,080

See accompanying notes to condensed consolidated financial statements



**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010**

Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)

	Six Months Ended June 30,	
	2011	2010
	(Unaudited)	(Unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 7,645	\$ 21,082
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	6,452	6,487
Provision for obsolete inventories	(6)	--
Amortization of deferred financing cost	1,707	563
Non-cash compensation expense	10,564	13,381
Debt discount amortization	824	1,681
Deferred taxes	388	(361)
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(47,251)	(65,925)
Inventories	17,659	(9,866)
Prepayments and deposits	(111,035)	(159)
Advances to suppliers and subcontractors	(64,336)	(31,947)
Other receivables	(351)	(4,070)
Increase (decrease) in:		
Accounts payable and accrued expenses	54,815	(392)
Advances from customers	3,151	3,953
Taxes payable	121	8,582
Deferred income	(470)	529
Net cash used in operating activities	(120,123)	(56,462)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to plant and equipment	(3,160)	(846)
Additions to intangible assets, other than through business acquisitions	(520)	(807)
Deposits refunded (paid) for business acquisitions, properties and intangible assets, net	16,905	(30,229)
Payments for business acquisitions	--	(422)
Net cash provided by (used in) investing activities	13,225	(32,304)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Restricted cash	(22,472)	--
Issue of common stock, net of financing expenses	--	64,573
Proceeds from borrowings, net of financing costs	356,720	141,533
Repayment of borrowings	(128,440)	(49,899)
Repayment of guaranteed senior unsecured notes payable	(19,320)	(19,320)
Proceeds from borrowings from obligations under product financing arrangements, net of financing costs	--	6,293
Repayment of obligation under product financing arrangements	(4,450)	(2,671)
Net cash provided by financing activities	182,038	140,509
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>75,140</b>	<b>51,743</b>

Effect of exchange rate changes on cash and cash equivalents		3,439		1,841
Cash and cash equivalents, beginning of period		65,626		154,483
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	\$	144,205	\$	208,067

Continued

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010**

**Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>SUPPLEMENTARY CASH FLOW INFORMATION:</b>	<b>(Unaudited)</b>	<b>(Unaudited)</b>
Interest paid	\$ 11,227	\$ 3,157
Income taxes paid	\$ 4,345	\$ 735

See accompanying notes to condensed consolidated financial statements

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

**1. BASIS OF PRESENTATION AND AGREEMENT AND PLAN OF MERGER**

(a) Basis of presentation

The accompanying financial statements as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010, have been prepared by CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. (the Company) without an audit. Pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's audited annual financial statements for the year ended December 31, 2010, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on February 28, 2011, as amended on April 29, 2011. Amounts as of December 31, 2010, are derived from these audited consolidated financial statements.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position as of June 30, 2011, results of operations for the three and six months ended June 30, 2011 and 2010, and cash flows for the six months ended June 30, 2011 and 2010, have been made. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the operating results for the full year.

The Company's operating results and operating cash flows historically have been subject to seasonal variations. The Company's revenues are usually higher in the second half of the year than in the first half, and the first quarter is usually the slowest quarter because fewer projects are undertaken during and around the Chinese spring festival.

(b) Agreement and plan of merger

On April 20, 2011, the Company entered into an Agreement and Plan of Merger with (1) Rightmark Holdings Limited, a British Virgin Islands company and wholly-owned subsidiary of Intelligent One Limited, a British Virgin Islands company wholly-owned by Mr. Guoshen Tu (Rightmark), (2) Rightmark Merger Sub Limited, a Delaware corporation and wholly-owned subsidiary of Rightmark (Merger Sub) and (3) Mr. Guoshen Tu, which was subsequently amended and restated by the Amended and Restated Agreement and Plan of Merger, dated as of May 3, 2011, by and among the same parties (such Agreement and Plan of merger, as amended and restated, the Merger Agreement). Under the Merger Agreement, Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly-owned subsidiary of Rightmark (the Merger). Mr. Guoshen Tu is the Company's Chief Executive Officer and the Chairman of the Company's Board of Directors and beneficially owns approximately 20.9% of the Company's outstanding shares of common stock.

Under the terms of the Merger Agreement, at the effective time of the Merger, each outstanding share of the Company's common stock will be converted automatically into the right to receive \$6.50 in cash, without interest, excluding certain shares as provided in the Merger Agreement. The Merger remains subject to the satisfaction or waiver of the conditions set forth in the Merger Agreement, including obtaining approval of the existing stockholders of the Company.

There are a number of risks and uncertainties relating to the Merger. For example, the Merger may not be consummated or may not be consummated in the timeframe or manner currently anticipated, as a result of several

factors, including, among other things, the failure of one or more of the Merger Agreement's closing conditions, Parent's failure to obtain sufficient financing to complete the Merger, or litigation relating to the Merger. In addition, there can be no assurance that approval of the Company's stockholders will be obtained, that the other conditions to closing of the Merger will be satisfied or waived or that other events will not intervene to delay or result in the termination of the Merger. If the Merger is not completed, the price of the Company's common stock may change to the extent that the current market price of its common stock may reflect an assumption that the Merger will be consummated.

Pending the closing of the Merger, the Merger Agreement also restricts the Company from engaging in certain actions without Parent's consent, which could prevent the Company from pursuing opportunities that may arise prior to the closing of the Merger. Any delay in closing or a failure to close could have a negative impact on the Company's business and stock price as well as the Company's relationships with its customers, vendors or employees, as well as a negative impact on the Company's ability to pursue alternative strategic transactions and/or the Company's ability to implement alternative business plans. In addition, if the Merger Agreement is terminated under certain circumstances, the Company is required to pay a termination fee of up to \$10,000.

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES**

**(a) Use of Estimates**

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Management makes these estimates using the best information available at the time the estimates are made; however actual results could differ materially from those estimates.

**(b) Fair Value Measurement**

The Company utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

*Level 1:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

*Level 2:* Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and

*Level 3:* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

At June 30, 2011 and December 31, 2010, the Company has no financial assets or liabilities subject to recurring fair value measurements.

The Company's financial instruments include cash and cash equivalents, accounts receivable, other receivables, accounts and bills payable, notes payable, obligations under product financing arrangements, and guaranteed senior unsecured notes payable. Management estimates that the carrying amounts of the non-related party financial instruments approximate their fair values due to their short-term nature and/or based on market interest rates currently available.

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(c) Cash and Cash Equivalents, and Restricted Cash**

The Company considers highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Restricted cash as of June 30, 2011, represents time deposits on account to secure short-term notes payable. Also see Note 10.

**(d) Accounts Receivable**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. The Company extends credit to its customers in the normal course of business and generally does not require collateral. The Company's credit terms in general are from 30 to 330 days, dependent upon the segment, the nature of the project, and the customer. The Company assesses the probability of collection from each customer at the outset of the arrangement based on a number of factors, including the customer's payment history and its current creditworthiness. If in management's judgment collection is not probable, the Company does not record revenue until the uncertainty is removed.

Management performs ongoing credit evaluations, and the Company maintains an allowance for potential credit losses based upon its loss history and its aging analysis. The allowance for doubtful accounts is the Company's best estimate of the amount of credit losses in existing accounts receivable. Management reviews the allowance for doubtful accounts each reporting period based on a detailed analysis of trade receivables. In the analysis, management primarily considers the age of the customer's receivable, and also considers the creditworthiness of the customer, the economic conditions of the customer's industry, general economic conditions and trends, and the business relationship and history with its customers, among other factors. If any of these factors change, the Company may also change its original estimates, which could impact the level of the Company's future allowance for doubtful accounts. If judgments regarding the collectability of receivables were incorrect, adjustments to the allowance may be required, which would reduce profitability.

Accounts receivable are recognized and carried at the original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful accounts receivable is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

As of June 30, 2011, one individual customer had an accounts receivable balance which represented approximately 29.1% of the Company's total accounts receivable. There was no other individual customer with a balance greater than 10% of total accounts receivable at June 30, 2011. As of December 31, 2010, one individual customer had an accounts receivable balance which represented approximately 13.5% of the Company's total accounts receivable. There was no other individual customer that had an accounts receivable balance greater than 10% of the Company's total accounts receivable at December 31, 2010.

From time to time, the Company enters into receivable factoring agreements. The Company accounts for these arrangements under Accounting Standards Codification (ASC) 860 *Transfers and Servicing*. These arrangements are without recourse, the receivables are isolated from the Company, the transferee has the right to pledge or exchange the receivables, and the Company does not maintain effective control over the receivables. Therefore, these arrangements

satisfy the conditions to be accounted for as a sale and the Company recognizes any gain or loss in earnings. The Company did not enter into any receivable factoring agreements during the six months ended June 30, 2011 and 2010.

**(e) Inventories**

Manufacturing, distribution and service segment inventories consist of raw materials, work in process and finished goods and are stated at the lower of cost, determined on a weighted average basis, or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale. When inventories are sold, their carrying amount is charged to expense in the period in which the revenue is recognized. Write-downs for declines in net realizable value or for losses of inventories are recognized as an expense in the period the impairment or loss occurs.

Installation segment contract costs are included within installations in process, a component of inventories, and include materials, labor and overhead related to the installations.



**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(e) Inventories continued**

As of June 30, 2011 and December 31, 2010, inventories held under the product financing arrangements (see Note 11) were \$12,544 and \$19,808, respectively.

During the three and six months ended June 30, 2011 and 2010, approximately 25%, 26%, 46% and 42%, respectively, of total inventory purchases were from five suppliers. Management believes that should the Company lose any one of its major suppliers, other suppliers are available that could provide similar products to the Company on comparable terms.

**(f) Accounting for Software to Be Sold, Leased or Marketed**

The Company accounts for software development costs in accordance with ASC 985-20 *Costs of Software to be Sold, Leased or Marketed*. Costs related to establishing the technological feasibility of a software product are expensed as incurred as a part of research and development in general and administrative expenses. Costs that are incurred to produce the finished product after technological feasibility is established are capitalized and amortized over the estimated economic life of five years. The Company performs periodic reviews to ensure that unamortized software development costs remain recoverable from future revenue.

As of June 30, 2011 and December 31, 2010, unamortized computer software costs were \$5,060 and \$5,331, respectively. During the three and six months ended June 30, 2011 and 2010, \$430, \$827, \$350 and \$663 of amortization expense was charged to income, respectively.

**(g) Goodwill**

Goodwill represents the excess of the purchase price over the net fair value of the identifiable tangible and intangible assets acquired and the fair value of liabilities assumed in acquisitions. ASC 350-30-50 *Goodwill and Other Intangible Assets*, requires the testing of goodwill and indefinite-lived intangible assets for impairment at least annually. The Company tests goodwill for impairment in the fourth quarter of each year.

Under applicable accounting guidance, the goodwill impairment analysis is a two-step test. The first step of the goodwill impairment test involves comparing the fair value of each reporting unit with its carrying amount including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired; however, if the carrying amount of the reporting unit exceeds its fair value, the second step must be performed to measure potential impairment.

The second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated possible impairment. If the implied fair value of goodwill exceeds the goodwill assigned to the reporting unit, there is no impairment. If the goodwill assigned to a reporting unit exceeds the implied fair value of goodwill, an impairment charge is recorded for the excess.

**(h) Revenue Recognition**

Revenues from sales of surveillance and safety products and systems are recognized in accordance with Staff Accounting Bulletin ( SAB ) No. 104: *Revenue Recognition* and related interpretations. Revenues are recognized when the following criteria are met:

- (i) Persuasive evidence of an arrangement exists The Company requires evidence of an agreement with a customer specifying the terms and conditions of the products to be delivered typically in the form of a signed contract or purchase order;
- (ii) Delivery has occurred For product sales, delivery generally takes place when titles to the products are shipped to or accepted by the customer;
- (iii) The fee is fixed or determinable Fees are fixed or determinable based on the contract or purchase order terms; and
- (iv) Collection is probable The Company performs a credit review of all customers with significant transactions to determine whether a customer is creditworthy and collection is probable.

All revenues are recognized net of any taxes collected from customers and subsequently remitted to governmental authorities.

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Expressed in thousands of U.S. dollars**  
**(Except for share and per share amounts)**

**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(h) Revenue Recognition continued**

Product sales contracts generally provide a one to three-year product warranty to customers from the date of purchase. The Company estimates the costs of satisfying warranty claims based on an analysis of past experience and provides for the future claims in the period the revenue is recognized. As of June 30, 2011 and December 31, 2010, no material product warranty reserve was accrued. Warranty costs incurred by the Company have not been material.

The Company derives a significant portion of its revenue from the supply and installation of surveillance and safety equipment in its Installation Segment; the two deliverables do not meet the separation criteria under ASC 605-25 *Multiple-Element Arrangements*. Installation segment contracts vary in terms of contract amount and period of performance. The performance period for short-term contracts is usually between three and six months. The period of performance for long-term contracts is typically between a year and 36 months. Long-term contracts generally are entered into with municipalities, provinces, or their affiliates located in China. These long-term contracts are further defined by agreed-upon detail specifications that outline defined stages. Completion of a defined stage represents basic service and products delivered, such as the installation of specified surveillance and safety systems in defined locations within the project area. Stages are typically planned to be completed over defined three to six-month periods. Each stage represents a discreet, defined phase of the total contract, for which completion can be readily determined. At the completion of a stage, and upon customer inspection, verification and acceptance of the work performed, the Company recognizes the fixed price per stage as revenue. At the time of stage completion, the Company considers the title to work performed passing to the customer. Other than a warranty reserve, discussed below, the Company has no further obligations to the customer for a completed stage.

The use of contract accounting requires significant judgment in estimating total contract pricing and costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, anticipated increases in wages and prices for subcontractor services and materials, and the availability of subcontractor services and materials. The Company's estimates are based upon the professional knowledge and experience of its engineers, program managers and other personnel, who review each long-term contract continually to assess the contract's schedule, performance, technical matters and estimated cost at completion. The risk to the Company on fixed-price contracts is that if estimates to complete the contract change from one period to the next, profit levels will vary from period to period.

Approximately 1% of contract installation revenue is deferred for repair work during the one-year warranty period. The Company monitors the warranty work requested by its customers, and has determined that minimal warranty work has historically been requested to be performed. Deferred income balances as of June 30, 2011 and December 31, 2010, were \$2,806 and \$3,201, respectively, and represented amounts invoiced but deferred as revenue as an estimated warranty reserve. Management believes that this 1% warranty reserve is adequate as of June 30, 2011 and December 31, 2010.

Repairs and maintenance service revenue is recognized when the service is performed.

The Company derives a portion of its revenue from one-year software upgrades. These services are typical post-contract service ( PCS ) arrangements according to ASC 985-605-25 *Revenue Recognition*. Under this guidance, PCS revenue may be recognized together with the initial licensing fee on delivery of the software if all of the following conditions are met:

- (i) The PCS fee is included with the initial licensing fee;
- (ii) The PCS included with the initial license is for one year or less;
- (iii) The estimated cost of providing PCS during the arrangement is insignificant; and
- (iv) Unspecified upgrades/enhancements offered during PCS arrangements historically have been and are expected to continue to be minimal and infrequent.

Revenue from surveillance and safety system with one-year software upgrades is recognized when delivery occurs and the risk of ownership passes to the customers, as the Company believes it meets the conditions above related its PCS arrangements and is therefore in compliance with applicable accounting guidance.

During the three months ended June 30, 2011, three customers contributed to more than 10% of the Company's revenue with each accounting for approximately 36.7%, 21.0% and 13.0% of the Company's revenue, respectively. There was no individual customer that accounted for more than 10% of the Company's revenue for the three months ended June 30, 2010. During the six months ended June 30, 2011, two customers contributed to more than 10% of the Company's revenue with each accounting for approximately 40.7% and 14.6% of the Company's revenue, respectively. During the six months ended June 30, 2010, one customer contributed to more than 10% of the Company's revenue which accounted for approximately 14.5% of the Company's revenue.

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
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**Expressed in thousands of U.S. dollars  
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**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(i) Research and Development Costs**

Research and development costs are expensed as incurred. Research and development costs included in general and administrative expenses for the three and six months ended June 30, 2011 and 2010, amounted to \$746, \$1,395, \$661 and \$1,294, respectively.

**(j) Advertising Costs**

The Company expenses advertising costs as incurred or the first time advertising takes place. During the three and six months ended June 30, 2011 and 2010, the Company incurred advertising costs of approximately \$2,828, \$3,962, \$915 and \$1,564, respectively.

**(k) Retirement Benefits**

Retirement benefits in the form of contributions under defined contribution retirement plans to the relevant authorities are charged to the consolidated statements of income as incurred. Retirement benefit expense for the three and six months ended June 30, 2011 and 2010, were \$494, \$941, \$294 and \$584, respectively, and are included in both selling and marketing expenses and general and administrative expenses.

**(l) Income taxes**

The Company accounts for income taxes using the asset and liability method prescribed by ASC 740 *Income Taxes*. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect in the year in which the differences are expected to reverse. The Company records a valuation allowance to offset deferred tax assets if based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of the deferred tax assets will not be realized. The effect on deferred taxes of a change in tax rates is recognized as income or loss in the period that includes the enactment date.

The Company does not have any material unrecognized tax benefits.

The Company files income tax returns with the relevant government authorities in the U.S. and the PRC. The Company is not subject to U.S. federal tax examinations for years before 2007. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. The Company does not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three and six months ended June 30, 2011 and 2010. The Company's effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses, preferential tax treatment, subsidiary tax rates different from the effective tax rate, and changes in the deferred tax valuation allowance.

**(m) Earnings Per Share**

ASC 260 *Earnings Per Share*, requires dual presentation of basic and diluted earnings per share (EPS) with a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. Basic EPS excludes dilution. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earnings per basic share of common stock is based on the weighted average number of shares of common stock outstanding during each respective period. Earnings per diluted share of common stock adds to basic weighted shares the weighted average number of shares issuable under convertible securities, contingent issuances, and warrants outstanding during each respective period, using the if-converted or treasury-stock methods.

Unvested restricted shares issued under the Equity Incentive Plan are not included in basic weighted average number of shares but are considered to be outstanding as of the grant date for purposes of computing diluted EPS even though the shares are subject to vesting requirements.

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**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(m) Earnings Per Share continued**

The calculation of diluted EPS also considers the dilutive effect of outstanding warrants for the three and six months ended June 30, 2011 and 2010. With respect to outstanding warrants, the dilutive impact on the weighted average number of shares as calculated under the if-converted method was 0, 0, 5,000 and 8,000 for the three and six months ended June 30, 2011 and 2010, respectively. Warrants which were outstanding to acquire 144,509, 144,509, 3,498,296 and 3,498,296 shares of common stock, respectively, were not included in the dilutive calculation for the three and six months ended June 30, 2011 and 2010, as the effect would be anti-dilutive.

Basic and diluted earnings per share for the three months ended June 30, 2011 and 2010 were calculated as follows:

	2011	2010
Net income attributable to the Company	\$ 5,966	\$ 17,803
Weighted average number of common shares:		
Basic	84,833,000	71,480,000
Effect of diluted securities:		
Warrants	--	5,000
Employee share-based compensation	4,876,000	4,521,000
Diluted	89,709,000	76,006,000
Earnings per share attributable to the Company		
Basic	\$ 0.07	\$ 0.25
Diluted	\$ 0.07	\$ 0.23

Basic and diluted earnings per share for the six months ended June 30, 2011 and 2010 were calculated as follows:

	2011	2010
Net income attributable to the Company	\$ 7,645	\$ 21,080
Weighted average number of common shares:		
Basic	84,835,000	67,993,000
Effect of diluted securities:		
Warrants	--	8,000
Employee share-based compensation	4,874,000	4,208,000
Diluted	89,709,000	72,209,000
Earnings per share attributable to the Company		
Basic	\$ 0.09	\$ 0.31
Diluted	\$ 0.09	\$ 0.29

**(n) Recently Issued and Adopted Accounting Pronouncements**

**Business Combinations**

*(Included in ASC 805 Business Combination, previously SFAS No. 141 (R))*

In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-29, *Business Combinations* (Topic 805): *Disclosure of Supplementary Pro Forma Information for Business Combinations*. This ASU specifies that when financial statements are presented, the revenue and earnings

of the combined entity should be disclosed as though the business combination 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 for business combinations with acquisition dates on or after January 1, 2011. The adoption of this update did not have an impact on the Company's consolidated financial statements.



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**2. SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(n) Recently Issued and Adopted Accounting Pronouncements - continued**

**Goodwill**

*(Included in ASC 350 Intangibles-Goodwill and Other )*

In December 2010, the FASB issued ASU No. 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 requires that reporting units with zero or negative carrying amounts perform step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. ASU 2010-28 is effective for the Company beginning with this interim period. The adoption of this update did not have an impact on the Company's financial condition or results of operations.

**Multiple Deliverable Revenue Arrangements**

*(Accounting Standards Updates 2009-13 and 2009-14)*

In October 2009, the FASB issued a new accounting standard which provides guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management's best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. In October 2009, the FASB also issued a new accounting standard which changes revenue recognition for tangible products containing software and hardware elements. Specifically, tangible products containing software and hardware that function together to deliver the tangible products' essential functionality are scoped out of the existing software revenue recognition guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance discussed above. Both standards were effective for the Company beginning on January 1, 2011. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

**3. ACCOUNTS AND OTHER RECEIVABLES**

The Company provides an allowance for doubtful accounts receivable. The receivables and allowance balances at June 30, 2011 and December 31, 2010 are as follows:

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Accounts receivable	\$ 494,142	\$ 436,700
Less: allowance for doubtful accounts	(2,773)	(2,714)
Accounts receivable, net	\$ 491,369	\$ 433,986

Other receivables primarily represent unsecured, short-term advances that the Company makes from time-to-time to third-party entities. These advances are due on demand.

**4. INVENTORIES**

Inventories consist of the following as of June 30, 2011 and December 31, 2010:

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Raw materials	\$ 13,218	\$ 12,449
Work in progress	2,394	2,713
Finished goods	15,619	13,465
Installations in process	14,128	32,953
Total	45,359	61,580
Less: allowance for obsolete inventories	(2,258)	(2,212)
Inventories, net	\$ 43,101	\$ 59,368

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**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
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**5. PREPAYMENTS AND DEPOSITS**

Prepayments and deposits consist of the following as of June 30, 2011 and December 31, 2010:

	<b>June 30,</b>	<b>December</b>
	<b>2011</b>	<b>31,</b>
		<b>2010</b>
Current assets		
- Prepaid expenses	\$ 3,406	\$ 3,392
- Installation contract deposits	165,183	52,849
	\$ 168,589	\$ 56,241
Non-current assets		
- Deposits paid for business acquisition	\$ 45,145	\$ 42,888
- Deposits paid for acquisition of land used rights, properties and intangible assets	87,608	103,355
	\$ 132,753	\$ 146,243

Installation contract deposits are made from time-to-time by the Company to demonstrate capital and resources in connection with bidding on certain projects. Such amounts are refundable upon the grant of the contract.

Non-current deposits are refundable on demand, and there are no binding commitments to acquire these assets.

**6. ADVANCES TO SUPPLIERS AND SUBCONTRACTORS**

The Company has made advances to third-party suppliers in advance of receiving inventory parts. These advances are generally made to expedite the delivery of required inventory when needed and to help to ensure priority and preferential pricing on such inventory. The amounts advanced to suppliers are fully refundable on demand and totaled \$133,292 and \$48,977 as of June 30, 2011 and December 31, 2010, respectively. The Company has also made advances to third-party subcontractors for work to be performed on certain projects. As work is performed by sub-contractors, such costs are allocated to installations in process (a component of inventories). Any unused amounts of such advances are refundable to the Company on demand. Advances to subcontractors were \$21,468 and \$39,383 as of June 30, 2011 and December 31, 2010, respectively.

**7. PLANT AND EQUIPMENT**

Plant and equipment consists of the following as of June 30, 2011 and December 31, 2010:

	<b>June 30,</b>	<b>December</b>
	<b>2011</b>	<b>31,</b>
		<b>2010</b>
Buildings	\$ 68,655	\$ 64,029
Leasehold improvements	3,738	4,362
Plant and equipment	8,712	8,687
Electronic equipment	10,220	9,872
Motor vehicles	5,942	5,327
	97,267	92,277
Less: accumulated depreciation	(19,946)	(16,983)

Plant and equipment, net                   \$       77,321   \$       75,294

Depreciation expense for the three and six months ended June 30, 2011 and 2010, was \$1,452, \$2,891, \$1,179 and \$2,388, respectively.

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**8. LAND USE RIGHTS**

Land use rights consist of the following as of June 30, 2011 and December 31, 2010:

	<b>June 30,</b>		<b>December</b>
	<b>2011</b>		<b>31, 2010</b>
Cost of land use rights	\$ 8,994	\$	8,791
Less: accumulated amortization	(952)		(895)
Land use rights, net	\$ 8,042	\$	7,896

Amortization expense for the three and six months ended June 30, 2011 and 2010, was \$53, \$149, \$58 and \$100, respectively.

Estimated amortization expense for the next five years and thereafter is as follows:

2011 (for the remaining six months)	\$	90
2012		179
2013		179
2014		179
2015		179
2016		179
Thereafter		7,057
Total	\$	8,042

**9. INTANGIBLE ASSETS**

Intangible assets consist of the following as of June 30, 2011 and December 31, 2010:

	<b>June 30,</b>		<b>December</b>
	<b>2011</b>		<b>31, 2010</b>
Trademarks (life of 11 to 25 years)	\$ 17,222	\$	17,222
Exclusive cooperation agreements (life of 20 years)	13,632		13,632
Customer base (life of 5 to 10 years)	10,448		10,448
Patents (life of 10 years)	4,542		4,542
Technical know-how (life of 9 to 10 years)	17,103		17,072
Non-compete agreements (life of 5 years)	1,303		1,303
Contracts in progress (life of 2 to 9 months)	410		410
Surveillance software (life of 5 years)	11,779		11,219
Surveillance recording system (life of 5 years)	500		500
	76,939		76,348
Less: accumulated amortization	(31,140)		(27,656)
Intangible assets, net	\$ 45,799	\$	48,692

Amortization expense for the three and six months ended June 30, 2011 and 2010, was \$1,720, \$3,412, \$2,016 and \$3,999, respectively.

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
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**9. INTANGIBLE ASSETS (CONTINUED)**

Estimated amortization expense for the next five years and thereafter is as follows:

2011 (remaining six months)	\$	3,496
2012		6,300
2013		5,670
2014		5,330
2015		4,038
2016		3,553
Thereafter		17,412
Total	\$	45,799

**10. NOTES PAYABLE**

The following is a summary of the Company's short-term and long-term notes payable as of June 30, 2011 and December 31, 2010:

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Bank loans	\$ 490,959	\$ 256,899
Less: current portion	(191,014)	(196,329)
Long-term portion	\$ 299,945	\$ 60,570

As of June 30, 2011, notes payable are due as follows:

	<b>Long-term Notes</b>	<b>Short-term Notes</b>	<b>Total</b>
2011(for the remaining six months)	\$ 1,214	\$ 97,273	\$ 98,487
2012	24,028	91,273	115,301
2013	152,721	--	152,721
2014	102,904	--	102,904
2015	3,100	--	3,100
2016	3,308	--	3,308
Thereafter	15,138	--	15,138
Total	\$ 302,413	\$ 188,546	\$ 490,959

On March 1, 2011, the Company entered into a term loan facility agreement with the China Development Bank Corporation Hong Kong Branch (CDB), pursuant to which CDB agreed to make available to the Company a term loan facility in an aggregate principal amount of up to \$200,000, subject to terms and conditions of the agreement. The Company borrowed \$200,000 from this facility on March 1, 2011. The loan carries an annual interest rate of 3% per annum over the applicable six-month London Inter Bank Offered Rate (3.40% as of June 30, 2011). Approximately \$800 of other costs directly associated with the facility were recorded as deferred financing costs in the balance sheet on March 1, 2011. The Company is amortizing these financing costs over the term of the loan. The loan under the facility will mature on the third anniversary of the first date when the facility is utilized by the Company with 50% of the principal due in August 2013 and the remaining 50% due in February 2014. Pursuant to the term loan facility agreement, if the Company's chairman and chief executive officer, Mr. Guoshen Tu, (the CEO or Mr. Tu) ceases to be the beneficial owner of at least 10% of the Company's outstanding capital stock, the facility may be cancelled and all outstanding amounts under the facility may become immediately due and payable with no less than 30 days notice. As

of June 30, 2011, this condition was satisfied, and management believes the Company is in compliance with all terms and conditions of the term loan facility agreement.

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**10. NOTES PAYABLE (CONTINUED)**

In October 2010, the Company entered into a term loan facility agreement with CDB, pursuant to which CDB agreed to make available to the Company a term loan facility in an aggregate principal amount of up to \$50,000, subject to terms and conditions of the agreement. The Company borrowed a total of \$50,000 on October 29, 2010 under the facility. The loan carries an annual interest rate of 3% per annum over the applicable six-month London Inter Bank Offered Rate (3.40% as of June 30, 2011). Approximately \$1,000 of other costs directly associated with the facility were recorded as deferred financing costs in the balance sheet on October 29, 2010. The Company is amortizing these financing costs over the term of the loan. The loan under the facility is due in October 2013. Pursuant to the term loan facility agreement, if Mr. Tu ceases to be the beneficial owner of at least 10% of the Company's outstanding capital stock, the facility may be cancelled and all outstanding amounts due under the facility may become immediately due and payable with no less than 30 days notice. As of June 30, 2011, this condition was satisfied, and management believes the Company is in compliance with all terms and conditions of the term loan facility agreement.

On June 17, 2011, the Company entered into a loan agreement with Bank of Jiangsu. The Company borrowed RMB5,000 (approximately \$773) with an interest rate equal to the 115% of the 12 month's benchmark lending rate of the People's Bank of China (7.26% as of June 30, 2011). The loan is due in June 2012. The loan is guaranteed by the CEO and a subsidiary of the Company and collateralized by the properties and land use rights of two subsidiaries.

On June 14, 2011, the Company entered into a loan agreement with Guangdong Development Bank. The Company borrowed RMB49,600 (approximately \$7,664) with an annual interest rate equal to 110% of the 12 months benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in June 2012 and guaranteed by the CEO and a subsidiary of the Company.

On June 13, 2011, the Company entered into a loan agreement with China Everbright Bank Co., Ltd. The Company borrowed RMB16,000 (approximately \$2,472) with an interest rate equal to 5.27% as of June 30, 2011, with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by a subsidiary of the Company and collateralized by a restricted cash amount of RMB16,000 (approximately \$2,472) of a subsidiary of the Company.

On May 27, 2011, the Company entered into a loan agreement with Bank of Jiangsu. The Company borrowed RMB15,000 (approximately \$2,318) with an interest rate equal to the 110% of the 12 month's benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011). The loan is due in May 2012. The loan is guaranteed by the CEO and a subsidiary of the Company and collateralized by the properties and land use rights of two subsidiaries.

On May 3, 2011 the Company entered into a loan agreement with Shanghai Pudong Development Bank. The Company borrowed RMB80,000 (approximately \$12,362) with an interest rate equal to 108% of the 12 month's benchmark lending rate of the People's Bank of China (6.81% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in May 2012. The loan is guaranteed by the CEO and a subsidiary of the Company and collateralized by the properties and land use rights of a subsidiary of the Company.

On April 29, 2011, the Company entered into a loan agreement with Shanghai Pudong Development Bank. The Company borrowed RMB80,000 (approximately \$12,362) with an interest rate equal to 108% of the 12 month's benchmark lending rate of the People's Bank of China (6.81% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in April 2012. The loan is guaranteed by the CEO and collateralized by the properties and land use rights of a subsidiary of the Company.



On April 20, 2011, the Company entered into a loan agreement with Bank of Jiangsu. The Company borrowed RMB50,000 (approximately \$7,726) with an interest rate equal to 110% of the 12 month s benchmark lending rate of the People s Bank of China (6.94% as of June 30, 2011). The loan is due in April 2012. The loan is guaranteed by the CEO and a subsidiary of the Company and collateralized by the properties and land use right of two subsidiaries of the Company.

On April 1, 2011, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB27,270 (approximately \$4,214) on April 1, 2011 and RMB12,770 (approximately \$1,973) on May 17, 2011 with interest rate equal to 12 month s benchmark lending rate of the People s Bank of China (6.31% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in March 2012 and guaranteed by three subsidiaries of the Company and is collateralized by the properties and land use rights of a subsidiary of the Company.

On April 1, 2011, the Company entered into a loan agreement with Societe Generale with loan facility up to RMB27,000 (approximately \$4,172), and in the same month, the Company withdrew RMB27,000 (approximately \$4,172) from the loan facility with annual interest rates ranging from 6.56% to 6.84% and are all due in October 2011. The loans are guaranteed by a subsidiary of the Company.

On March 24, 2011, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB31,500 (approximately \$4,867) with an annual interest rate equal to the 1 to 6 month s benchmark lending rate of the People s Bank of China (5.85% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in September 2011 and guaranteed by a subsidiary of the Company.

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**10. NOTES PAYABLE (CONTINUED)**

On March 21, 2011, the Company entered into a loan agreement with China Construction Bank. The Company borrowed RMB50,000 (approximately \$7,726) with an annual interest rate equal to 7.20%, with interest payable on the 20th of each month. The loan is due in March 2012. The loan is guaranteed by the CEO and two subsidiaries of the Company and collateralized by the property of a subsidiary of the Company.

On March 16, 2011, the Company entered into a loan agreement with Guangdong Development Bank. The Company borrowed RMB121,000 (approximately \$18,697) with an annual interest rate equal to 105% of the 1 to 6 month s benchmark lending rate of the People s Bank of China (6.14% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in March 2012 and collateralized by a restricted cash amount of \$20,000 of a subsidiary of the Company.

On February 9, 2011, the Company entered into a loan agreement with Societe Generale. The Company borrowed RMB27,000 (approximately \$4,172) with an annual interest rate equal to 9.10%, with interest payable on the due date of the loan. The loan was due and repaid in March 2011 and guaranteed by a subsidiary of the Company.

On February 1, 2011, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB59,000 (approximately \$9,117) with an annual interest rate equal to 105% of the 1 to 3 year s benchmark lending rate of the People s Bank of China (6.72% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2012. The loan is guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary of the Company.

On January 31, 2011, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB100,040 (approximately \$15,458) with an annual interest rate equal to 95% of the 12 month s benchmark lending rate of the People s Bank of China (5.99% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in January 2012 and guaranteed by four subsidiaries of the Company.

On January 12, 2011, the Company entered into a loan agreement with China Zheshang Bank. The Company borrowed RMB20,000 (approximately \$3,090) with an annual interest rate equal to 120% of the 6 to 12 month s benchmark lending rate of the People s Bank of China (7.57% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in August 2011 and guaranteed by the CEO and two subsidiaries of the Company.

On January 10, 2011, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB40,000 (approximately \$6,180) on January 10, 2011, and RMB169,340 (approximately \$26,167) on February 9, 2011 with an annual interest rate equal to 105% of the 5 to 10 year s benchmark lending rate of the People s Bank of China (7.14% as of June 30, 2011), with principal and interest payable in each quarter. In March and June 2011, the Company repaid principal of the loan in the amount of RMB5,439 (approximately \$840) and RMB3,704 (approximately \$572) in accordance with the terms of the loan, respectively. The final maturity of the loan is January 2021. The loan is guaranteed by Shenzhen Zhonghe Industrial Limited, an independent third party, and is secured by the rights of properties currently under construction which will be acquired by the Company upon their completion.

On January 4, 2011, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB10,000 (approximately \$1,545) with an annual interest rate equal to 105% of the 1 to 3 year s benchmark lending rate of the People s Bank of China (6.72% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2012. The loan is guaranteed by the CEO, his wife and a subsidiary of

the Company, and collateralized by the property and land use rights of a subsidiary.

On December 29, 2010, the Company entered into a loan agreement with Bank of China. The Company borrowed RMB71,100 (approximately \$10,986) with an annual interest rate equal to 5.15%, with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by the CEO and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

On December 24, 2010, the Company entered into a loan agreement with Bank of China. The Company borrowed RMB71,100 (approximately \$10,986) with an annual interest rate equal to 5.15%, with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by the CEO and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

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**10. NOTES PAYABLE (CONTINUED)**

On December 10, 2010, the Company entered into a loan agreement with Shanghai Pudong Development Bank. The Company borrowed RMB66,000 (approximately \$10,198) with an annual interest rate equal to the 6 month s benchmark lending rate of the People s Bank of China (5.85% as of June 30, 2011), with interest payable on the 20th of each month. The loan was due in June 2011. The loan was collateralized by a cash deposit of Whitehorse Technology Limited, a company wholly-owned by the CEO. The Company repaid RMB6,650 (approximately \$1,028), RMB6,600 (approximately \$1,020), RMB20,250 (approximately \$3,129) and RMB32,500 (approximately \$5,021) in January, March, April and June 2011, respectively.

On December 2, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB70,000 (approximately \$10,816) with an annual interest rate equal to 105% of the 1 to 3 year s benchmark lending rate of the People s Bank of China (6.72% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2012. The loan is guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

On November 19, 2010, the Company entered into a loan agreement with Industrial and Commercial Bank of China. The Company borrowed RMB30,000 (approximately \$4,636) on December 21, 2010, RMB30,000 (approximately \$4,636) on December 29, 2010 and RMB40,000 (approximately \$6,181) on January 31, 2011 with an annual interest equal to 95% of the 12 month s benchmark lending rate of the People s Bank of China (5.99% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by three subsidiaries of the Company and collateralized by the property of a subsidiary.

On November 17, 2010, the Company entered into a loan agreement with Bank of China. The Company borrowed RMB48,600 (approximately \$7,510) with an annual interest rate equal to 5.15%, with interest payable on the 20th of each month. The loan was due and repaid in May 2011. The loan was guaranteed by the CEO and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

On October 29, 2010, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB51,000 (approximately \$7,881) with an annual interest rate equal to 95% of the 12 month s benchmark lending rate of the People s Bank of China (5.99% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2011. The loan is guaranteed by three subsidiaries of the Company and collateralized by the property of a subsidiary.

On October 18, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB25,000 (approximately \$3,863) with an annual interest equal to 110% of the 12 month s benchmark lending rate of the People s Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in October 2011. The Company repaid RMB12,500 (approximately \$1,932) in April 2011. The loan is guaranteed by the Chief Operating Officer of the Company, the CEO and his wife.

On August 18, 2010, the Company entered into a loan agreement with Shenzhen Development Bank. The Company borrowed RMB40,000 (approximately \$6,181) with an annual interest rate equal to the 12 month s benchmark lending rate of the People s Bank of China (6.31% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in August 2011. The loan is guaranteed by the CEO and two subsidiaries of the Company and collateralized by the property of a subsidiary.

On August 9, 2010, the Company entered into a loan agreement with Societe Generale. The Company borrowed RMB27,000 (approximately \$4,172) with an annual interest rate equal to 5.35%, with interest payable on the due date of the loan. The loan was due and repaid in February 2011 and guaranteed by a subsidiary of the Company.

On July 26, 2010, the Company entered into a loan agreement with China Everbright Bank Co., Ltd. The Company borrowed RMB40,000 (approximately \$6,181) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan was due and repaid in July 2011 and guaranteed by the CEO, a subsidiary of the Company and Chuang Guan.

On July 21, 2010, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB54,600 (approximately \$8,437) with an annual interest rate equal to 12 month's benchmark lending rate of the People's Bank of China (6.31% as of June 30, 2011), with interest payable on the 20th of each month. The loan was due and repaid in July 2011. The loan is guaranteed by three subsidiaries of the Company and collateralized by the property of a subsidiary.

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**10. NOTES PAYABLE (CONTINUED)**

On July 15, 2010, the Company entered into a loan agreement with China Construction Bank. The Company borrowed RMB30,000 (approximately \$4,636) with an annual interest rate equal to 110% of the 12 month benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan was due and repaid in July 2011 and collateralized by the property of a subsidiary.

On July 1, 2010, the Company entered into a loan agreement with Guangdong Development Bank. The Company borrowed RMB49,600 (approximately \$7,664) with an annual interest rate equal to 110% of the 12 month benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan was guaranteed by the CEO and a subsidiary of the Company. The loan was due and repaid in June 2011.

On June 18, 2010, the Company entered into a loan agreement with Industrial and Commercial Bank of China (Asia) Limited. The Company borrowed \$8,000 and \$2,000 on July 15, 2010 and August 12, 2010, respectively, with an effective interest rate at 3% per annum over the applicable one year London Inter Bank Offered Rate (3.73% at June 30, 2011), with interest payable on the due date of the loan. Interest payable is calculated on the basis of the actual number of days elapsed and a 360-day year. The loan was due in July 2011 and extended to July 2012 under a supplementary agreement signed on June 23, 2011. The loan is guaranteed by the CEO of the Company and collateralized by fixed assets of a subsidiary and the shares of a subsidiary.

On April 16, 2010, the Company entered into a loan agreement with Shanghai Pudong Development Bank. The Company borrowed RMB80,000 (approximately \$12,362) with an annual interest rate equal to 6.06%, with interest payable on the 20th of each month. The loan was due and repaid in April 2011. The loan was guaranteed by the CEO and a subsidiary of the Company and collateralized by the properties and land use rights of a subsidiary.

On April 15, 2010, the Company entered into a loan agreement with Shanghai Pudong Development Bank. The Company borrowed RMB80,000 (approximately \$12,362) with an annual interest rate equal to 6.06%, with interest payable on the 20th of each month. The loan was due and repaid in April 2011. The loan was guaranteed by the CEO and collateralized by the properties and land use rights of a subsidiary of the Company.

On March 31, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB50,000 (approximately \$7,726) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

On March 25, 2010, the Company entered into a loan agreement with China Citic Bank. The Company borrowed RMB90,000 (approximately \$13,907) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the properties of two subsidiaries of the Company.

On March 24, 2010, the Company entered into a loan agreement with China Citic Bank. The Company borrowed RMB60,000 (approximately \$9,271) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the properties of two subsidiaries of the Company.

On March 4, 2010, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB31,000 (approximately \$4,790) with an annual interest rate equal to 5.23%, with interest payable on the 20th of each month. The loan was due in March 2011, but repaid in February 2011. The loan was guaranteed by three subsidiaries of the Company and collateralized by the property of a subsidiary.

On March 4, 2010, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB39,000 (approximately \$6,026) with an annual interest rate equal to 5.23%, with interest payable on the 20th of each month. The loan was due in March 2011, but repaid in January 2011. The loan was guaranteed by three subsidiaries of the Company and collateralized by the property of a subsidiary.

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**10. NOTES PAYABLE (CONTINUED)**

On March 3, 2010, the Company entered into a loan agreement with China Construction Bank. The Company borrowed RMB50,000 (approximately \$7,726) with an annual interest rate equal to 6.10%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by the CEO and a subsidiary of the Company and collateralized by the property of a subsidiary.

On March 2, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB41,000 (approximately \$6,335) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

On February 3, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB59,000 (approximately \$9,117) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in February 2011. The loan was guaranteed by the CEO, his wife and a subsidiary of the Company and collateralized by the property and land use rights of a subsidiary.

On January 26, 2010, the Company entered into a loan agreement with the Industrial and Commercial Bank of China. The Company borrowed RMB100,000 (approximately \$15,452) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan was due in January 2011. The Company repaid RMB80,000 (approximately \$12,362) and RMB20,000 (approximately \$3,090) in June 2010 and January 2011, respectively. The loan was guaranteed by the CEO.

**11. OBLIGATIONS UNDER PRODUCT FINANCING ARRANGEMENTS**

In June 2010, the Company entered into product financing agreements with a financial institution. Under the terms of the agreements, the Company agreed to pay an annual interest rate of 8.23% on inventory financings. The Company borrowed RMB50,000 (approximately \$7,726). The loans expire in June 2013, and payments of principal and interest are due at the end of each quarter.

In September 2009, the Company entered into product financing agreements with a financial institution. Under the terms of the agreements, the Company agreed to pay an annual interest rate of 8.46% on inventory financings. The Company borrowed RMB50,000 (approximately \$7,726). The loans expire in September 2012, and payments of principal and interest are due at the end of each quarter.

In February 2009, the Company entered into product financing agreements with a financial institution. Under the terms of the agreements, the Company agreed to pay an annual interest rate of 10.5% on inventory financings. The Company borrowed RMB 7,114 (approximately \$1,099). The loans expire in September 2013, and payments of principal and interest are due at the end of each quarter.

In July 2008, the Company entered into product financing agreements with a financial institution. Under the terms of the agreements, the Company agreed to pay an annual interest rate of 10% on inventory financings. The Company borrowed RMB53,492 (approximately \$8,266). The loans were repaid in full in June 2011.

The Company incurred \$239, \$526, \$192 and \$463 during the three and six months ended June 30, 2011 and 2010, of interest expense on the product financing arrangements, respectively.





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**11. OBLIGATIONS UNDER PRODUCT FINANCING ARRANGEMENTS (CONTINUED)**

The following is a summary of the Company's obligations under product financing arrangements as of June 30, 2011 and December 31, 2010:

	<b>June 30,</b>	<b>December</b>
	<b>2011</b>	<b>31,</b>
		<b>2010</b>
Obligation under product financing arrangements	\$ 9,322	\$ 13,161
Less: current portion	(5,512)	(6,687)
Long-term portion	\$ 3,810	\$ 6,474

Estimated repayments for the terms of the arrangements are as follows:

2011 (for the remaining six months)	\$ 3,072
2012	5,369
2013	1,650
Total	10,091
Less: amount representing interest	(769)
Net	\$ 9,322

Approximately \$1,223 and \$1,863 of other costs directly associated with the product financing agreements are recorded as deferred financing costs in the balance sheet as of June 30, 2011 and December 31, 2010, respectively. The Company is amortizing these financing costs over the terms of the respective obligations. This amortization is recorded as interest expense.

**12. GUARANTEED SENIOR UNSECURED NOTES PAYABLE**

As of June 30, 2011, the Company has outstanding Tranche B Zero Coupon Guaranteed Senior Unsecured Notes (the Tranche B Notes). The Tranche B Notes had an original principal amount of \$84,000, zero coupon interest and a fair value of \$78,440, resulting in a debt discount of \$5,560 and an effective interest rate of approximately 5%. The notes mature on September 2, 2012. The Company is to repay the principal amount in six consecutive semi-annual installments, which began on March 2, 2010, with 46%, 46% and 8% of the principal amount to be repaid in the first, second and third year, respectively. The Tranche B Notes are not convertible. The Company is entitled to redeem the Tranche B Notes at any time with no premium or penalty at a redemption price equal to 100% of the principal amount of the Tranche B Notes to be redeemed, plus default interest, if any. The Tranche B Notes are guaranteed by the Company's significant subsidiaries to the extent permitted under the applicable laws. The Company repaid \$19,320 of the principal on the Tranche B Notes in each of March 2011 and March 2010.

The Company has recorded \$300, \$824, \$731 and \$1,681 of debt discount amortization for the three and six months ended June 30, 2011 and 2010, respectively, related to the Tranche B Notes. This amount is included in interest expense.

Approximately \$300 of legal fees and other costs directly associated with the issuance of the Tranche B Notes was recorded as deferred financing costs. The Company is amortizing these financing costs over the term of the Tranche B Notes.



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**12. GUARANTEED SENIOR UNSECURED NOTES PAYABLE (CONTINUED)**

The following is a summary of the Company's guaranteed senior unsecured notes payable as of June 30, 2011 and December 31, 2010:

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Total	\$ 25,492	\$ 43,988
Less: current portion	(22,168)	(37,408)
Long-term portion	\$ 3,324	\$ 6,580

Repayments under the terms of the notes are as follows:

2011 (remaining six months)	\$ 19,320
2012	6,720
Total	26,040
Less: amount representing unamortized discount	(548)
Net	\$ 25,492

**13. WARRANTS**

A summary of the status of the Company's warrants and the changes during the three months ended June 30, 2011 and 2010, is presented below:

	<b>2011</b>		<b>2010</b>	
	Shares	Weighted Average Exercise Prices	Shares	Weighted Average Exercise Prices
Outstanding at April 1	157,373	\$ 18.05	3,528,302	\$ 8.72
Granted	--	--	--	--
Exercised	--	--	--	--
Outstanding at June 30	157,373	\$ 18.05	3,528,302	\$ 8.72
Warrants exercisable at June 30	157,373	\$ 18.05	3,528,302	\$ 8.72

A summary of the status of the Company's warrants and the changes during the six months ended June 30, 2011 and 2010, is presented below:

	<b>2011</b>		<b>2010</b>	
	Shares	Weighted Average Exercise Prices	Shares	Weighted Average Exercise Prices
Outstanding at January 1	157,373	\$ 18.05	3,528,302	\$ 8.72
Granted	--	--	--	--
Exercised	--	--	--	--
Outstanding at June 30	157,373	\$ 18.05	3,528,302	\$ 8.72
Warrants exercisable at June 30	157,373	\$ 18.05	3,528,302	\$ 8.72



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#### 14. EQUITY INCENTIVE PLAN

On February 7, 2007, the Company adopted the 2007 Equity Incentive Plan, which was amended in February 2010 (the Plan). The Plan, as amended, has a ten-year term and provides for grants of stock options, stock appreciation rights, performance units, restricted stock units and performance shares. The total number of shares which may be issued under the Plan is 12,000,000. These restricted stock awards represent share-based payments subject to the provisions of ASC 718 *Stock Compensation*. The fair value of these restricted stock awards are equal to the fair value of the Company's stock on the date of grant. Such restricted stock is subject to the risk of forfeiture upon the occurrence of certain events.

During the three and six months ended June 30, 2011 and 2010, the Company granted 0, 200,908, 568,987 and 1,255,692 shares of restricted stock, respectively. During the three and six months ended June 30, 2011 and 2010, 18,250, 18,250, 16,089 and 75,254 shares of restricted stock were forfeited and retired, respectively. The shares that have been issued vest over a four to five-year period, and at issuance, resulted in total deferred compensation of \$102,258 and \$101,554 as of June 30, 2011 and December 31, 2010, respectively. The fair values of these restricted stock awards are equal to the fair value of the Company's common stock on the date of grant, after taking into account certain discounts. Such restricted stock is subject to the risk of forfeiture upon the occurrence of certain events. During the three and six months ended June 30, 2011 and 2010, the Company recognized \$5,017, \$10,564, \$5,055 and \$13,381, respectively, of compensation expense under the Plan. As of June 30, 2011 and December 31, 2010, there was \$31,034 and \$40,895, respectively, of unrecognized compensation expense related to the nonvested restricted stock. This cost is expected to be recognized over a four to five-year period. During the three and six months ended June 30, 2011 and 2010, the Company has not recognized any tax benefits for the compensation expense under the Plan.

The following table summarizes the status of the Company's nonvested restricted stock awards during the three months ended June 30, 2011 and 2010:

	Nonvested Restricted Stock and Stock Unit 2011		Nonvested Restricted Stock and Stock Unit 2010	
	Number of Shares	Weighted Average Grant Date Fair Values	Number of Shares	Weighted Average Grant Date Fair Values
Outstanding at April 1	5,991,688	\$ 6.16	4,484,468	\$ 9.11
Granted	--	--	568,987	6.42
Vested	(594,037)	(8.45)	(463,323)	(10.91)
Forfeited	(18,250)	(9.06)	(16,089)	(8.97)
Outstanding at June 30	5,379,401	\$ 5.90	4,574,043	\$ 8.60

The following table summarizes the status of the Company's nonvested restricted stock awards during the six months ended June 30, 2011 and 2010:

	Nonvested Restricted Stock and Stock Unit 2011		Nonvested Restricted Stock and Stock Unit 2010	
--	--	--	--	--

	Number of Shares		Weighted Average Grant Date Fair Values	Number of Shares		Weighted Average Grant Date Fair Values
Outstanding at January 1	6,485,008	\$	6.42	4,713,983	\$	9.47
Granted	200,908		4.32	1,255,692		7.16
Vested	(1,288,265)		(8.20)	(1,320,378)		(10.13)
Forfeited	(18,250)		(9.06)	(75,254)		(12.76)
Outstanding at June 30	5,379,401	\$	5.90	4,574,043	\$	8.60

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**15. CONSOLIDATED SEGMENT DATA**

Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions and assesses operating performance. The segment data presented reflects this segment structure. The Company reports financial and operating information in the following four segments:

- (a) System installation: designs, sells, installs, services and monitors electronics surveillance and safety systems to residential, commercial, industrial and governmental customers (the Installation segment );
- (b) Manufacturing of surveillance and safety products: designs, manufactures and sells surveillance and safety products, including intrusion security, access control and video management systems (the Manufacturing segment );
- (c) Distribution of surveillance and safety products: sells surveillance and safety products, including intrusion security, access control and video management systems (the Distribution segment ); and
- (d) Providing surveillance and safety services: provides a full range of surveillance and safety services, including network alarm response services, surveillance and safety products and solutions post-sale, maintenance services, software upgrading services, project integration services, security guard services, surveillance and safety consulting services, and surveillance and safety trustee services (the Service segment ).

The Company also provides general corporate services to its segments and these costs are reported as Corporate and others .

Selected information in the segment structure is presented in the following tables for the three and six months ended June 30, 2011 and 2010:

Revenues by segment for the three months ended June 30, 2011 and 2010, are as follows:

<b>Revenues<sup>(1)</sup></b>	<b>2011</b>		<b>2010</b>	
Installation segment	\$	118,048	\$	129,349
Manufacturing segment		30,338		21,979
Distribution segment		7,150		13,673
Service segment		803		3,353
<b>Total</b>	\$	156,339	\$	168,354

Revenues by segment for the six months ended June 30, 2011 and 2010 are as follows:

<b>Revenues<sup>(1)</sup></b>	<b>2011</b>		<b>2010</b>	
Installation segment	\$	197,797	\$	222,098
Manufacturing segment		44,542		37,988
Distribution segment		12,006		25,105
Service segment		1,048		3,353
<b>Total</b>	\$	255,393	\$	288,544

<sup>(1)</sup> Revenues by operating segments exclude intercompany transactions.





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**15. CONSOLIDATED SEGMENT DATA (CONTINUED)**

Income (loss) by segment for the three months ended June 30, 2011 and 2010 are as follows:

<b>Income (loss) from operations:</b>	<b>2011</b>	<b>2010</b>
Installation segment	\$ 31,719	\$ 32,797
Manufacturing segment	(1,601)	189
Distribution segment	(808)	(1,008)
Service segment	(634)	206
Corporate and others <sup>(1)</sup>	(14,029)	(7,630)
<b>Income from operations</b>	<b>14,647</b>	<b>24,554</b>
Corporate interest income	222	53
Corporate interest expense	(6,436)	(3,064)
Corporate other income	715	394
<b>Income before income taxes</b>	<b>9,148</b>	<b>21,937</b>
Income taxes	(3,182)	(4,130)
<b>Net income</b>	<b>\$ 5,966</b>	<b>\$ 17,807</b>

Income (loss) by segment for the six months ended June 30, 2011 and 2010 are as follows:

<b>Income (loss) from operations:</b>	<b>2011</b>	<b>2010</b>
Installation segment	\$ 56,249	\$ 52,539
Manufacturing segment	(4,390)	(862)
Distribution segment	(1,778)	(1,669)
Service segment	(1,488)	206
Corporate and others <sup>(1)</sup>	(25,821)	(18,697)
<b>Income from operations</b>	<b>22,772</b>	<b>31,517</b>
Corporate interest income	363	131
Corporate interest expense	(11,550)	(5,359)
Corporate other income	1,311	640
<b>Income before income taxes</b>	<b>12,896</b>	<b>26,929</b>
Income taxes	(5,251)	(5,847)
<b>Net income</b>	<b>\$ 7,645</b>	<b>\$ 21,082</b>

<sup>(1)</sup> Includes non-cash employee compensation, professional fees and consultancy fees for the Company.

Non-cash employee compensation by segment for the three months ended June 30, 2011 and 2010 are as follows:

<b>Non-cash employee compensation:</b>	<b>2011</b>	<b>2010</b>
Installation segment	\$ 266	\$ 587
Manufacturing segment	954	968
Distribution segment	220	386
Service segment	25	12
Corporate and others	3,552	3,102
<b>Total</b>	<b>\$ 5,017</b>	<b>\$ 5,055</b>

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**15. CONSOLIDATED SEGMENT DATA (CONTINUED)**

Non-cash employee compensation by segment for the six months ended June 30, 2011 and 2010 are as follows:

<b>Non-cash employee compensation:</b>	<b>2011</b>	<b>2010</b>
Installation segment	\$ 636	\$ 1,153
Manufacturing segment	1,910	1,904
Distribution segment	493	748
Service segment	51	12
Corporate and others	7,474	9,564
Total	\$ 10,564	\$ 13,381

Depreciation and amortization by segment for the three months ended June 30, 2011 and 2010 are as follows:

<b>Depreciation and amortization:</b>	<b>2011</b>	<b>2010</b>
Installation segment	\$ 877	\$ 1,089
Manufacturing segment	1,712	1,590
Distribution segment	206	354
Service segment	5	13
Corporate and others	425	207
Total	\$ 3,225	\$ 3,253

Depreciation and amortization by segment for the six months ended June 30, 2011 and 2010 are as follows:

<b>Depreciation and amortization:</b>	<b>2011</b>	<b>2010</b>
Installation segment	\$ 1,714	\$ 2,180
Manufacturing segment	3,466	3,176
Distribution segment	422	706
Service segment	12	13
Corporate and others	838	412
Total	\$ 6,452	\$ 6,487

Total assets by segment as of June 30, 2011 and December 31, 2010 are as follows:

<b>Total assets</b>	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Installation segment	\$ 766,949	\$ 585,439
Manufacturing segment	214,947	197,899
Distribution segment	37,279	46,074
Service segment	16,073	13,905
Corporate and others <sup>(1)</sup>	383,393	267,705
Total	\$ 1,418,641	\$ 1,111,022

<sup>(1)</sup> Includes deposits paid for acquisition of subsidiaries, properties and intangible assets.

Goodwill by segment as of June 30, 2011 and December 31, 2010, is as follows:

<b>Goodwill</b>	<b>June 30, 2011</b>	<b>December 31, 2010</b>
Installation segment	\$ 11,079	\$ 11,079

Manufacturing segment		56,456		56,456
Distribution segment		11,984		11,981
Total	\$	79,519	\$	79,516

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**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

**16. CONTINGENCIES**

Between March 15, 2011 and April 26, 2011, six purported class action complaints related to the Merger (the Stockholder Actions ) were filed against some or all of the following: the Company, the members of the board of directors of the Company and Merger Sub. On March 15, 2011, the first of the Stockholder Actions was filed in the Court of Chancery of the State of Delaware, captioned Dziak v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6279-CS (the Dziak Complaint ). The plaintiff in the Dziak Complaint alleges, among other things, (1) that members of our board of directors breached their fiduciary duties to the Company's stockholders in connection with the Merger and (2) Mr. Tu engaged in acts of self-dealing, unfair dealing, gross overreaching and breaches of his fiduciary duties. The Dziak Complaint seeks, among other things, an order enjoining the defendants from proceeding with the Merger unless and until such time the defendants have acted in accordance with their fiduciary duties to maximize shareholder value, an order directing the defendants to exercise their fiduciary duties to obtain a transaction that is in the best interests of our stockholders, an award of compensatory damages and an award of fees, expenses and costs.

From March 16, 2011 to April 26, 2011, five additional complaints were filed in the Court of Chancery of the State of Delaware, seeking substantially the same relief and making substantially the same allegations as the Dziak Complaint. The additional complaints have the following captions: Levine v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6286-CS (filed March 16, 2011); Smith v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6292-CS (filed March 17, 2011); O Connor v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6296-CS (filed March 18, 2011); Jamal v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6408-CS (filed April 22, 2011); and Musto v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6418-CS (filed April 26, 2011). Certain of the Stockholder Actions additionally allege, among other things, that the Company and Merger Sub have aided and abetted the individual defendants' alleged breaches of fiduciary duties. Certain of the Stockholder Actions additionally seek, among other things, (1) an order enjoining, preliminarily and permanently, the Merger, and (2) an order rescinding the Merger or awarding plaintiff and the class rescissory damages in the event that the Merger is consummated prior to the entry of the court's final judgment.

On May 23, 2011, plaintiffs' counsel in Musto v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6418-CS, filed a motion with the Court of Chancery of the state of Delaware seeking to consolidate five of the pending actions and to have counsel for Mr. Musto appointed as lead plaintiffs' counsel in the consolidated action. On May 27, 2011, the Company, members of the special committee, Terence Yap, and Merger Sub, respectively, filed motions to dismiss the remaining action that was not part of the consolidation motion, Jamal v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6408-CS. On June 7, 2011, four plaintiffs (Levine, Smith, O Connor, and Jamal) filed a joint Amended Complaint containing substantially the same allegations and seeking substantially the same relief as the prior complaints. The joint Amended Complaint was accompanied by a motion for preliminary injunction to block the Merger and a motion to expedite discovery. On June 10, 2011, plaintiffs' counsel in the Dziak, Levine, Smith, O Connor, and Jamal actions filed a joint cross-motion to the Musto consolidation motion. The joint cross-motion also sought consolidation of all pending actions, but requested that the law firm of Rigrodsky & Long, P.A. be appointed as lead plaintiffs' counsel in the consolidated action. At a hearing on June 30, 2011, the Court ordered that the six pending cases be consolidated and appointed Rigrodsky & Long, P.A. as the lead plaintiffs' counsel in the consolidated action.

In September 2010, the Company was notified by the staff of the SEC that it had initiated a SEC Investigation. On or around September 3, 2010 and March 29, 2011, the Company received two separate subpoenas from the SEC requesting the delivery of certain documents to the SEC. The Company is cooperating, and intends to continue to

cooperate, with the SEC in connection with such investigation. Receipt of these subpoenas does not mean that the SEC has concluded that the Company or anyone else has violated the law. The investigation does not mean that the SEC has a negative opinion of any person, entity or security. It is not possible to predict the outcome of the investigation, including whether or when any proceedings might be initiated, when these matters may be resolved or what, if any, penalties or other remedies may be imposed.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

*Special Note Regarding Forward Looking Statements*

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. We use words such as believe, expect, anticipate, project, target, plan, optimistic, intend, aim, will or similar expressions which are intended to identify forward-looking statements. Such statements include, among others, those concerning market and industry segment growth and demand and acceptance of new and existing products; any projections of sales, earnings, revenue, margins or other financial items, any statements of the plans, strategies and objectives of management for future operations; any statements regarding future economic conditions or performance; uncertainties related to conducting business in China, as well as all assumptions, expectations, predictions, intentions or beliefs about future events. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, as well as assumptions, that, if they were to ever materialize or prove incorrect, could cause the results to differ materially from those expressed or implied by such forward-looking statements. Such risks and uncertainties, among others, include:

- Our ability to attract new customers;
- Our ability to employ and retain qualified employees;
- Our ability to successfully integrate companies that we have acquired and to avoid or mitigate potential damages arising from risks associated with acquired companies and the legal structures utilized to effectuate acquisitions of these companies;
- Our ability to keep pace with technological developments in the surveillance and safety industry, and to develop and commercialize new products;
- Competition and competitive factors in the markets in which we compete;
- General economic and business conditions in China and in the local economies in which we regularly conduct business, which can affect demand for the Company's products and services;
- Changes in laws, rules and regulations governing the business community in China in general and the surveillance and safety industry in particular; and
- The risks identified in the Risk Factors section included in the Company's annual report on Form 10-K for the year ended December 31, 2010, as amended, and the subsequent SEC filings.

As discussed below, we entered into an Agreement and Plan of Merger on April 20, 2011 which was amended and restated on May 3, 2011 (the Merger Agreement) under which our Chief Executive Officer and Chairman Tu Guoshen has agreed to acquire all of our outstanding common stock for \$6.50 per share in cash, subject to the certain exceptions and conditions set forth in the Merger Agreement (the Merger). All forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations do not include the potential impact of the Merger Agreement or the transaction contemplated thereunder. In addition, any forward-looking statements relating to the Merger are subject to various risks and uncertainties, including uncertainties as to the timing of the Merger, the possibility that alternative acquisition proposals will be made, the possibility that alternative

acquisition proposals will not be made, the possibility that various closing conditions for the Merger may not be satisfied or waived; the possibility that Parent and Merger Sub will be unable to obtain sufficient funds to close the Merger; the failure of the Merger to close for any other reason, the amount of fees and expenses related to the Merger, the diversion of management's attention from ongoing business concerns, the effect of the announcement of the Merger on our business relationships, operating results and business generally, including our ability to retain key employees, the Merger Agreement's contractual restrictions on the conduct of our business prior to the completion of the Merger, the possible adverse effect on our business and the price of our common stock if the Merger is not completed in a timely manner or at all, and the outcome of any legal proceedings, regulatory proceedings or enforcement matters that have been or may be instituted against us and others relating to the Merger.

### *Use of terms*

Except as otherwise indicated by the context, references to CSR, we, us, our, our Company, or the Company mean China Security & Surveillance Technology, Inc., a Delaware corporation, and its consolidated subsidiaries. Unless the context otherwise requires, all references to:

- Allied Rich are to Allied Rich Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Chain Star are to Chain Star Investments Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Cheng Feng are to Shanghai Cheng Feng Digital Technology Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Chuang Guan are to Shenzhen Chuang Guan Intelligence Network Technology Co., Ltd., a corporation incorporated in the People's Republic of China;
- Coson are to Shenzhen Coson Electronic Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly-owned subsidiary of the Company;

- CSSD are to China Security & Surveillance Distribution (PRC) Inc., a corporation incorporated in the People's Republic of China and a direct, wholly-owned subsidiary of the Company;
- CSSI are to China Security & Surveillance Intelligence (PRC) Inc., previously named China Security & Surveillance Manufacturing (PRC) Inc., a corporation incorporated in the People's Republic of China and a direct, wholly-owned subsidiary of the Company;
- CSST Investment are to China Security & Surveillance Investment (PRC) Inc., a corporation incorporated in the People's Republic of China and a direct, wholly-owned subsidiary of the Company;
- CSSS are to China Security & Surveillance Services (PRC) Inc., a corporation incorporated in the People's Republic of China and a direct, wholly-owned subsidiary of the Company;
- CSST HK are to China Security & Surveillance Technology (HK) Ltd., a Hong Kong corporation and an indirect, wholly-owned subsidiary of the Company;
- CSST PRC are to China Security & Surveillance Technology (PRC) Inc., a corporation incorporated in the People's Republic of China and a direct, wholly-owned subsidiary of the Company;
- DIT are to DIT Industry (H.K.) Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- DM are to Beijing DM Security & Technology Co., Ltd., a corporation incorporated in the People's Republic of China;
- Golden are to Golden Group Corporation (Shenzhen) Limited, a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Guanling are to Beijing Aurine Divine Land Technology Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- HiEasy are to HiEasy Electronic Technology Development Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Hongtianzhi are to Shenzhen Hongtianzhi Electronics Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Huge Long are to Huge Long Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Jin Lin are to Shenzhen Jin Lin Technology Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Kit Grant are to Kit Grant Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Link Billion are to Link Billion Investment Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Long Top are to Long Top Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Longhorn are to Shenzhen Longhorn Security Technology Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Minking are to Changzhou Minking Electronics Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- Multiwin are to Multiwin International Holdings Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Ocean Pacific are to Ocean Pacific Technology Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Safetech are to China Safetech Holdings Limited, a British Virgin Islands corporation and a direct, wholly owned subsidiary of the Company;
- Sharp Eagle are to Sharp Eagle (H.K.) Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Sincere On are to Sincere On Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Stonesonic are to Guangdong Stonesonic Digital Technique Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;



- Tsingvision are to Hangzhou Tsingvision Intelligence System Co., Ltd., a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- WDH are to Shenzhen Wandaiheng Industry Limited, a corporation incorporated in the People's Republic of China and an indirect, wholly owned subsidiary of the Company;
- BVI are to the British Virgin Islands;
- PRC and China are to the People's Republic of China;
- Renminbi and RMB refer to the legal currency of China;
- U.S. dollar, dollars and \$ refer to the legal currency of United States;
- Exchange Act are to the Securities Exchange Act of 1934, as amended; and
- Securities Act are to the Securities Act of 1933, as amended.

### *Overview of Our Business*

We manufacture, distribute, install and service surveillance and safety products and systems and develop surveillance and safety related software in China. We generate revenues within four primary operating segments: Installation Segment, Manufacturing Segment, Distribution Segment and Service Segment. A majority of our revenues is derived from the provision of surveillance and safety packaged solutions which include the products, installation and after-sale service maintenance to our customers. Because the majority of our revenues are derived from installations, they are generally non-recurring. Maintenance services in our packaged solution are included for the first year from the date of completion. Our customers may extend our maintenance program after the first year for an additional fee.

Our Manufacturing Segment revenue is primarily derived from the sales of our products, excluding products sold in connection with the installation projects described above. The acquisitions of: Hongtianzhi, HiEasy, and Minking in 2007; the acquisitions of Stonesonic, Longhorn and DIT in 2008; and the acquisition of Coson in 2009 collectively expanded and are expected to continue to expand our manufacturing business. We sell our cameras, DVRs, software, alarm systems, access control systems, and other products to various vendors primarily in China. Although we have sold a small number of manufactured products internationally, we do not anticipate that the international market will be a significant source of revenues for us in the foreseeable future.

Our customers are primarily comprised of: (1) Chinese governmental entities and their affiliates, such as cities, municipalities, provinces, customs agencies, courts, public security bureaus, and prisons; (2) non-profit organizations, including schools, museums, sports arenas, and libraries; and (3) commercial entities, such as airports, hotels, real estate developments, banks, mines, railways, supermarkets, and entertainment venues.

In the Installation Segment, contracts vary in amount and period of performance. The performance period for short-term contracts is usually between three and six months. Short-term contract award amounts are typically less than \$7 million. Our long-term contracts are typically in excess of one year, and up to 36 months. In general, long-term contract awards have historically been in excess of \$40 million, and have been entered into with municipalities, cities and provinces, or their affiliates located in China. These long-term contracts are further defined by agreed-upon detailed specifications that outline defined stages. Completion of a defined stage represents basic service and products delivered, such as the installation of specified surveillance and safety systems in defined locations within the project area. Stages are typically planned to be completed over defined three to six-month periods. Each stage represents a discreet, defined phase of the total contract, for which completion can be readily determined. At the completion of a stage, and upon customer inspection, verification and acceptance of the work performed, we recognize as revenue, the agreed-upon fixed price for the installation work completed in the respective stage. Other than a warranty reserve, we have no further obligations to the customer for a completed stage.

In the Manufacturing and Distribution Segments, we sell products under purchase agreements, supply contracts and purchase orders on a routine basis. Purchase orders tend to be of a relatively short duration. The pricing is generally fixed and the quantities are based on individual purchase orders. The individual contract amount in these segments is typically less than RMB1 million (approximately \$150,000). Revenue is recognized when title transfers, which is usually upon shipment of products, and when all revenue recognition criteria have been satisfied.

The use of contract accounting requires significant judgment in estimating total contract pricing and costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, anticipated increases in wages and prices for subcontractor services and materials, and the availability of subcontractor services and materials. Our estimates are based upon the professional knowledge and experience of our engineers, program managers and other personnel, who review each long-term contract continually to assess the contract's schedule, performance, technical matters and estimated cost at completion. Our risk on fixed-price contracts is that if estimates to complete the contract change from one period to the next, profit levels will vary from period to period.

Our sales network covers most of China's populated areas, and we do not rely on any particular region for our business. Our subsidiaries collectively have more than 150 branch offices and distribution points.

As previously disclosed, on April 20, 2011, we entered into an Agreement and Plan of Merger with Rightmark Holdings Limited, a British Virgin Islands company and wholly owned subsidiary of Intelligent One Limited, a British Virgin Islands company wholly owned by Mr. Guoshen Tu ( Rightmark ), Rightmark Merger Sub Limited, a Delaware corporation and wholly owned subsidiary of Rightmark ( Merger Sub ) and Mr. Guoshen Tu (solely for the purpose of Section 6.15) which was subsequently amended and restated by the Amended and Restated Agreement and Plan of Merger, dated as of May 3, 2011, by and among the same parties. Under the Merger Agreement, Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly owned subsidiary of Rightmark. Mr. Guoshen Tu is the Company's Chief Executive Officer and the Chairman of the Company's Board of Directors and beneficially owns approximately 20.9% of the Company's outstanding shares of common stock.

Under the terms of the Merger Agreement, at the effective time of the Merger, each outstanding share of the Company's common stock will be converted automatically into the right to receive \$6.50 in cash, without interest, excluding certain shares as provided in the Merger Agreement. The Merger remains subject to the satisfaction or waiver of the conditions set forth in the Merger Agreement, including obtaining approval of the existing stockholders of the Company.

The foregoing description of the Merger Agreement and guaranty is qualified in its entirety by reference to the full text of the Merger Agreement and Guaranty, copies of which have been filed as Exhibits to our current report on Form 8-K dated April 21, 2011, and which are incorporated herein by reference.

### ***Reportable Operating Segments***

Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions and assesses operating performance. We set up a new service segment for provision of a full range of surveillance and safety services and realigned our management and segment reporting structure effective April 1, 2010. We now report financial and operating information in the following four segments:

(a) The Installation Segment provides design, sales, installation, services and monitoring of electronics surveillance and safety systems to residential, commercial, industrial and governmental customers;

(b) The Manufacturing Segment provides design, manufacturing and sales of surveillance and safety products, including intrusion security, access control and video management systems;

(c) The Distribution Segment provides distribution and sales of surveillance and safety products and services, including intrusion security, access control and video management systems; and

(d) The Service Segment provides a full range of surveillance and safety services, including network alarm response services, surveillance and safety products and solutions post-sale, maintenance services, software upgrading services, project integration services, security guard services, surveillance and safety consulting services, and surveillance and safety trustee services.

We also provide general corporate services to our segments and these costs are reported as Corporate and Others.

The Service Segment represents approximately 0.5% and 2.0% of revenues and approximately 4.3% and 0.8% of operating loss or income for the three months ended June 30, 2011 and 2010, respectively, and it represents approximately 0.4% of revenues and 6.5% of operating loss for the six months ended June 30, 2011. However, because we believe the Service Segment will expand substantially in the future, we have made the decision to show it as a separate segment.

### ***Second Quarter Financial Performance Highlights***

Our financial results in the second quarter of 2011 were affected by the structural change in our customer mix. During the second quarter, the majority of our revenues was generated from large scale government projects. As we succeeded in securing more larger scale installation projects which generally require longer installation time, we completed less installation projects in this quarter. Despite the revenue decrease, our gross margin improved from 25.8% in the second quarter of 2010 to 26.9% in the second quarter of 2011. We believe the surveillance and safety product market in China will remain strong due, in part, to favorable government initiatives and a general rise in affluence of the population of China.

Following are some financial highlights for the second quarter of 2011:

- *Revenues*: Revenues decreased \$12.01million, or 7.1%, to \$156.34 million for the second quarter of 2011, from \$168.35 million for the same quarter of last year.
- *Gross margin*: Gross margin was 26.9% for the three months ended June 31, 2011, compared to 25.8% for the three months ended June 30, 2010.
- *Income from operations*: Income from operations decreased \$9.91 million, or 40.4%, to \$14.65 million for the three months ended June 30, 2011, from \$24.56 million for the three months ended June 30, 2010.
- *Operating margin*: Operating margin (the ratio of income from operations to revenues, expressed as a percentage) was 9.4% for the three months ended June 30, 2011, compared to 14.6% for the same period in 2010.
- *Net income attributable to the Company*: Net income attributable to the Company decreased \$11.84 million, or 66.5%, to \$5.97 million for the three months ended June 30, 2011, from \$17.81 million for the three months ended June 30, 2010.
- *Net margin*: Net margin (the ratio of net income attributable to the Company to revenues, expressed as a percentage) was 3.9% for the three months ended June 30, 2011, compared to 10.6% for the three months ended June 30, 2010.
- *Fully diluted net income per share*: Fully diluted net income per share was \$0.07 for the three months ended June 30, 2011, as compared to \$0.23 for the three months ended June 30, 2010.

**Results of Operations**

The following table sets forth key components of our results of operations for the three and six months ended June 30, 2011 and 2010, in dollars and as a percentage of revenues.

(All amounts, other than percentages, in millions of U.S. dollars)

	Three months ended				Six months ended			
	June 30,		June 30,		June 30,		June 30,	
	2011		2010		2011		2010	
<b>Revenues</b>	\$ 156.34	100.0%	\$ 168.35	100.0%	\$ 255.39	100.0%	\$ 288.54	100.0%
Cost of goods sold (including depreciation and amortization for the three and six months ended June 30, 2011 and 2010 of \$0.25, \$0.51, \$0.25 and \$0.50, respectively)	(114.33)	73.1%	(124.99)	74.2%	(181.90)	71.2%	(216.20)	74.9%
<b>Gross profit</b>	42.01	26.9%	43.36	25.8%	73.49	28.8%	72.34	25.1%
Selling and marketing	(3.11)	2.0%	(3.13)	1.8%	(5.81)	2.3%	(5.85)	2.0%
General and administrative	(16.26)	10.4%	(7.61)	4.6%	(28.39)	11.2%	(15.60)	5.5%
Non-cash employee compensation	(5.02)	3.2%	(5.05)	3.0%	(10.57)	4.1%	(13.38)	4.6%
Depreciation and amortization	(2.97)	1.9%	(3.01)	1.8%	(5.94)	2.3%	(5.99)	2.1%
<b>Income from operations</b>	14.65	9.4%	24.56	14.6%	22.78	8.9%	31.52	10.9%
Other income	0.94	0.6%	0.44	0.3%	1.67	0.7%	0.77	0.3%
Interest expense	(6.44)	4.1%	(3.06)	1.8%	(11.55)	4.5%	(5.36)	1.9%
<b>Income before income taxes</b>	9.15	5.9%	21.94	13.1%	12.90	5.1%	26.93	9.3%
Income taxes	(3.18)	2.0%	(4.13)	2.5%	(5.25)	2.1%	(5.85)	2.0%
<b>Net income attributable to the Company</b>	\$ 5.97	3.9%	\$ 17.81	10.6%	\$ 7.65	3.0%	\$ 21.08	7.3%

**Revenues**

Our revenues are primarily generated from system installations, manufacturing and distribution of surveillance and safety products and providing surveillance and safety services. Revenues decreased \$12.01 million, or 7.1%, to \$156.34 million for the three months ended June 30, 2011 from \$168.35 million for the three months ended June 30, 2010. Revenues decreased \$33.15 million, or 11.5%, to \$255.39 million for the six months ended June 30, 2011 from \$288.54 million for the six months ended June 30, 2010. Due to our marketing efforts and increased brand recognition, we were able to secure a greater number of larger scale installation projects in the first half of 2011 which requires longer periods of time to complete the installation. As a result, we completed a lesser number of installation

projects in the first half of 2011, which led to the decrease in our revenues in 2011. Most of local government's 2011 Safe City projects were at the bidding stage in the first half of 2011. Historically, the first quarter has generally been a slow quarter for us largely because fewer projects are undertaken during and around the Chinese New Year holiday, and the fourth quarter has generally been the strongest quarter. Management expects the same trend in 2011.

The following table shows the revenues recognized in the second quarter of 2011:

(In millions of U.S. dollars)

Revenues from the Installation Segment recognized from contracts signed before March 31, 2011	\$	70.51
Revenues from the Installation Segment recognized from contracts signed in the second quarter of 2011		47.54
Revenues from the Manufacturing Segment recognized from contracts signed before March 31, 2011		17.82
Revenues from the Manufacturing Segment recognized from contracts signed in the second quarter of 2011		12.52
Revenues from the Distribution Segment recognized from contracts signed before March 31, 2011		7.09
Revenues from the Distribution Segment recognized from contracts signed in the second quarter of 2011		0.06
Revenues from the Service Segment recognized from contracts signed before March 31, 2011		0.80
Revenues from the Service Segment recognized from contracts signed in the second quarter of 2011		--
Total revenues recognized in the second quarter of 2011	\$	156.34
Revenues deferred	\$	2.81
Backlog of sales contracts signed before June 30, 2011 <sup>(1)</sup>	\$	266.43

(1) We have conservatively not included letters of intent, framework agreements and various other agreements in our backlog numbers as they are subject to final binding agreements to be entered into at later dates.

The following table shows the different segments comprising our total revenues for the three and six months ended June 30, 2011 and 2010.

(All amounts in millions of U.S. dollars)

Revenues	Three months ended June 30,			
	2011		2010	
Installation Segment	\$ 118.05	75.5%	\$ 129.35	76.8%
Manufacturing Segment	30.34	19.4%	21.98	13.1%
Distribution Segment	7.15	4.6%	13.67	8.1%
Service Segment	0.80	0.5%	3.35	2.0%
Total	\$ 156.34	100.0%	\$ 168.35	100.0%

Revenues	Six months ended June 30,			
	2011		2010	
Installation Segment	\$ 197.79	77.5%	\$ 222.10	76.9%
Manufacturing Segment	44.54	17.4%	37.99	13.2%
Distribution Segment	12.01	4.7%	25.10	8.7%
Service Segment	1.05	0.4%	3.35	1.2%
Total	\$ 255.39	100.0%	\$ 288.54	100.0%

For the three months ended June 30, 2011 and 2010, our Installation Segment generated revenues of \$118.05 million and \$129.35 million which represented 75.5% and 76.8% of our total revenues, respectively. For the six months ended June 30, 2011 and 2010, our Installation Segment generated revenues of \$197.79 million and \$222.10 million which represented 77.5% and 76.9% of our total revenues, respectively. This decrease in revenues was mainly because a fewer number of projects were completed during the first and second quarter of 2011 as compared to the same periods in last year. More of our installation projects were in progress at June 30, 2011. During the three months ended June 30, 2011, three customers contributed to more than 10% of our revenue with each accounting for approximately 36.7%, 21.0% and 13.0% of our revenue, respectively. There was no individual customer that accounted for more than 10% of our revenue for the three months ended June 30, 2010. During the six months ended June 30, 2011, two customers contributed to more than 10% of our revenue with each accounting for approximately 40.7% and 14.6% of our revenue, respectively. During the six months ended June 30, 2010, one customer contributed to more than 10% of our revenue which accounted for approximately 14.5% of our revenue.

For the three months ended June 30, 2011 and 2010, our Manufacturing Segment generated revenues of \$30.34 million and \$21.98 million, representing 19.4% and 13.1% of our total revenues, respectively. For the six months ended June 30, 2011 and 2010, our Manufacturing Segment generated revenues of \$44.54 million and \$37.99 million, representing 17.4% and 13.2% of our total revenues, respectively. This increase in revenues was primarily driven by the decrease of sales prices due to market competition which, in turn, increased sales volume.

For the three months ended June 30, 2011 and 2010, our Distribution Segment generated revenues of \$7.15 million and \$13.67 million, representing 4.6% and 8.1% of our total revenues. For the six months ended June 30, 2011 and 2010, our Distribution Segment generated revenues of \$12.01 million, representing 4.7% of our total revenues for the six months ended June 30, 2011, as compared to \$25.10 million and 8.7% for the same period last year. Such decrease was mainly due to a decrease of selling prices due to market competition.

For the three months ended June 30, 2011 and 2010, our Service Segment generated revenues of \$0.80 million and \$3.35 million, representing 0.5% and 2.0% of our total revenues, respectively. Such decrease in amount and percentage was mainly because some of our service contracts will be rendered in the second half of 2011 instead of being rendered in the whole year range for 2010. For the six months ended June 30, 2011, our Service Segment, which was established in the second quarter of 2010, generated revenues of \$1.05 million, representing 0.4% of our total revenues.



Management believes that revenues from the installation projects will continue to be the Company's major revenue source in the next few years.

***Cost of goods sold***

Our cost of goods sold is primarily comprised of the costs of our raw materials, labor and overhead. Cost of goods sold for the second quarter of 2011 decreased by \$10.66 million, or 8.5%, to \$114.33 million, as compared to \$124.99 million for the same period last year. Cost of goods sold for the six months ended June 30, 2011 decreased by \$34.30 million, or 15.9%, to \$181.90 million, as compared to \$216.20 million for the same period last year.

The following table shows the different segments comprising our cost of goods sold for the three and six months ended June 30, 2011 and 2010.

(All amounts in millions of U.S. dollars)

Cost of goods sold	Three months ended June 30,			
	2011		2010	
Installation Segment	\$ 83.03	72.7%	\$ 93.41	74.8%
Manufacturing Segment	24.62	21.5%	15.98	12.8%
Distribution Segment	6.08	5.3%	12.81	10.2%
Service Segment	0.60	0.5%	2.79	2.2%
Total	\$ 114.33	100.0%	\$ 124.99	100.0%

Cost of goods sold	Six months ended June 30,			
	2011		2010	
Installation Segment	\$ 135.41	74.5%	\$ 163.12	75.5%
Manufacturing Segment	35.36	19.4%	27.54	12.7%
Distribution Segment	10.32	5.7%	22.75	10.5%
Service Segment	0.81	0.4%	2.79	1.3%
Total	\$ 181.90	100.0%	\$ 216.20	100.0%

The cost of goods sold related to the Installation Segment decreased by \$10.38 million, or 11.1% to \$83.03 million for the three months ended June 30, 2011, from \$93.41 million for the three months ended June 30, 2010. The cost of goods sold related to the Installation Segment decreased by \$27.71 million, or 17.0% to \$135.41 million for the six months ended June 30, 2011, from \$163.12 million for the six months ended June 30, 2010. The dollar decrease was mainly due to the decreased number of completed installation projects in the three and six months ended June 30, 2011.

The cost of goods sold related to the Manufacturing Segment increased to \$24.62 million for the three months ended June 30, 2011 as compared to \$15.98 million for the three months ended June 30, 2010, mainly due to the increase in revenues. The cost of goods sold related to the Manufacturing Segment increased to \$35.36 million for the six months ended June 30, 2011 as compared to \$27.54 million for the six months ended June 30, 2010, this increase in cost of goods sold was mainly due to the increase in revenues.

The cost of goods sold related to our Distribution Segment for the three months ended June 30, 2011 was \$6.08 million, decreased from \$12.81 million for same period last year. The cost of goods sold related to our Distribution Segment for the six months ended June 30, 2011 was \$10.32 million, decreased from \$22.75 million for the same period in 2010. This decrease in cost of goods sold was mainly due to the decrease in revenues.

The cost of goods sold related to our Service Segment, which was established in the second quarter of 2010, was \$0.60 million and \$0.81 million for the three and six months ended June 30, 2011, respectively, as compared to \$2.79 million for the three months ended June 30, 2010. The decrease in cost of goods sold in 2011 was generally in line with the revenue decrease.

### ***Gross profit and gross margin***

Our gross profit is equal to the difference between our revenues and our cost of goods sold. Our gross profit decreased \$1.35 million, or 3.1%, to \$42.01 million for the three months ended June 30, 2011, from \$43.36 million for the same period last year. Gross margin for the three months ended June 30, 2011 was 26.9%, as compared to 25.8% for the same period of 2010. The decrease in gross profit was mainly driven by the fewer number of installation projects completed in the second quarter of 2011. Our gross profit increased \$1.15 million, or 1.6%, to \$73.49 million for the six months ended June 30, 2011, from \$72.34 million for the same period last year. Gross margin for the six months

ended June 30, 2011 was 28.8%, as compared to 25.1% for the same period of 2010. The increase was mainly driven by an increasing gross margin in the Installation Segment, as discussed in more detail below, and disciplined execution of cost control initiatives.

The following table shows the different segment components comprising our gross profit margin over the three and six months ended June 30, 2011 and 2010.

<b>Gross Margin</b>	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Installation Segment	29.7%	27.8%	31.5%	26.6%
Manufacturing Segment	18.9%	27.3%	20.6%	27.5%
Distribution Segment	14.9%	6.3%	14.1%	9.4%
Service Segment	25.9%	16.7%	22.9%	16.7%
Total	26.9%	25.8%	28.8%	25.1%

For the three months ended June 30, 2011, gross margins of the Installation Segment, Manufacturing Segment, Distribution Segment and Service Segment were approximately 29.7%, 18.9%, 14.9% and 25.9%, respectively, compared to 27.8%, 27.3%, 6.3% and 16.7% for the same period last year. For the six months ended June 30, 2011, gross margins for the Installation Segment, Manufacturing Segment, and Distribution Segment were approximately 31.5%, 20.6% and 14.1%, respectively, compared to 26.6%, 27.5% and 9.4% for the same period last year. For the six months ended June 30, 2011, gross margin of the Service Segment, which was established in the second quarter of 2010, was 22.9% .

The increase in our gross margin for the Installation Segment was primarily because a larger proportion of our revenue was generated from larger scale projects in the first half of 2011 as compared to the same period in 2010. We are generally able to demand higher price and enjoy higher margin for larger scale projects. The security installation competitive landscape in China is dominated by many small vendors (who may not have all the necessary qualifications to perform larger scale projects which we often bid on). These smaller vendors typically focus on the retail and small corporate customer market segments instead of larger scale projects. Many competitors we typically face in smaller scale projects are often either eliminated in the bidding process or disqualified from bidding on large scale projects. As a result, we typically face a significantly reduced number of competitors on larger scale projects, which generally allowed us to command relatively higher prices. In addition, we also benefited from our experiences gained from our past installation projects and our research in developing more cost-effective installation processes, project design and solutions for our customers. As a result, we were able to reduce certain hardware components used in our installation projects while maintaining or improving the level of services to our customers.

The decrease in our gross margin for the Manufacturing Segment for the three and six months ended June 30, 2011 was primarily driven by the decrease of selling prices in an effort to maintain and expand our customer base, which resulted in a higher volume of sales. The increase in our gross margins for the Distribution Segment and the Service Segment for the three and six months ended June 30, 2011 were primarily due to cost efficiency.

### ***Selling and marketing expenses***

Our selling and marketing expenses are comprised primarily of sales commissions, the cost of advertising and promotional materials, salaries and fringe benefits of sales personnel, after-sale support services and other sales related costs.

Our selling and marketing expenses decreased \$0.02 million, or 0.6%, to \$3.11 million for the three months ended June 30, 2011 from \$3.13 million for the same period in 2010. As a percentage of revenues, our selling and marketing expenses increased to 2.0% for the three months ended June 30, 2011 from 1.8% for the same period in 2010. In the first six months of fiscal 2011, our selling and marketing expenses decreased \$0.04 million or 0.7% to \$5.81 million from \$5.85 million in the same period of last year. As a percentage of revenues, our selling and marketing expenses increased to 2.3% for the six months ended June 30, 2011 from 2.0% for the same period in 2010. The percentage increase was mainly due to our decreased revenues.

### ***General and administrative expenses***

General and administrative expenses consist primarily of compensation and benefits to our general management, finance and administrative staff, professional advisor fees, audit fees and other expenses incurred in connection with general operation.

Our general and administrative expenses increased \$8.65 million, or 113.7%, to \$16.26 million for the three months ended June 30, 2011 from \$7.61 million of the same period in 2010. In the first six months of 2011, our general and administrative expenses increased \$12.79 million, or 82.0% to \$28.39 million from \$15.60 million for the six months ended June 30, 2010. As a percentage of revenues, general and administrative expenses increased to 10.4% and 11.2%

for the three and six months ended June 30, 2011, respectively, from 4.6% and 5.5% for the same periods in 2010. We have incurred significantly more professional expenses in connection with the Merger transaction in 2011. In addition, our general and administrative expenses were also negatively impacted by increased advertising expense and hiring of additional staff.

***Non-cash employee compensation***

Non-cash employee compensation by segment for the three and six months ended June 30, 2011 and 2010 is as follows:

(All amounts in millions of U.S. dollars)

Non-cash employee compensation	Three months ended June 30,			
	2011		2010	
Installation Segment	\$ 0.27	5.4%	\$ 0.59	11.7%
Manufacturing Segment	0.95	18.9%	0.97	19.2%
Distribution Segment	0.22	4.4%	0.38	7.5%
Service Segment	0.03	0.6%	0.01	0.2%
Corporate and others	3.55	70.7%	3.10	61.4%
Total	\$ 5.02	100.0%	\$ 5.05	100.0%

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**Six months ended June 30,****Non-cash employee compensation**

	<b>2011</b>		<b>2010</b>	
Installation Segment	\$ 0.64	6.1%	\$ 1.15	8.6%
Manufacturing Segment	1.91	18.1%	1.91	14.3%
Distribution Segment	0.49	4.6%	0.75	5.6%
Service Segment	0.06	0.6%	0.01	0.1%
Corporate and others	7.47	70.6%	9.56	71.4%
Total	\$ 10.57	100.0%	\$ 13.38	100.0%

Effective February 7, 2007, our board of directors adopted the 2007 Equity Incentive Plan which was subsequently amended in February 2010 (the Plan). The Plan provides for grants of stock options, stock appreciation rights, performance units, restricted stock, restricted stock units, and performance shares. A total of 12,000,000 shares of our common stock may be issued under the Plan. The Plan has a 10-year term.

During the three and six months ended June 30, 2011, we granted an aggregate of 0, and 200,908 shares of restricted stock pursuant to the Plan to our employees and consultants, respectively. These shares will vest with respect to each of the employees and consultants over a period of four-to-five-year.

Non-cash employee compensation for the three months ended June 30, 2011 decreased to \$5.02 million from \$5.05 million for the same period in 2010. In the first six months of fiscal 2011, non-cash employee compensation decreased to \$10.57 million from \$13.38 million. The decrease in non-cash employee compensation was primarily because fewer shares were granted to employees and consultants under the Plan during the respective period.

***Depreciation and amortization***

Depreciation and amortization by segment for the three and six months ended June 30, 2011 and 2010 is as follows:

(All amounts in millions of U.S. dollars)

**Three months ended June 30,**

<b>Depreciation and amortization</b>	<b>2011</b>		<b>2010</b>	
Installation Segment	\$ 0.88	27.3%	\$ 1.09	33.4%
Manufacturing Segment	1.71	53.1%	1.59	48.8%
Distribution Segment	0.20	6.2%	0.35	10.7%
Service Segment	0.01	0.3%	0.01	0.3%
Corporate and others	0.42	13.1%	0.22	6.8%
Total	\$ 3.22	100.0%	\$ 3.26	100.0%

**Six months ended June 30,**

<b>Depreciation and amortization</b>	<b>2011</b>		<b>2010</b>	
Installation Segment	\$ 1.72	26.7%	\$ 2.18	33.6%
Manufacturing Segment	3.46	53.6%	3.18	49.0%
Distribution Segment	0.42	6.5%	0.70	10.8%
Service Segment	0.02	0.3%	0.01	0.2%
Corporate and others	0.83	12.9%	0.42	6.4%
Total	\$ 6.45	100.0%	\$ 6.49	100.0%

Our depreciation and amortization expense decreased \$0.04 million, or 1.2%, to \$3.22 million (including \$0.25 million depreciation and amortization costs included under cost of goods sold) for the three months ended June 30,

2011 from \$3.26 million for the same period in 2010. As a percentage of revenues, depreciation and amortization expenses increased to 2.1% for the three months ended June 30, 2011 from 1.9% for the same period in 2010. This percentage increase was primarily due to the decrease in revenues in the second quarter of 2011.

In the first six months of fiscal 2011, our depreciation and amortization decreased \$0.04 million, or 0.6%, to \$6.45 million (including \$0.51 million depreciation and amortization costs included under cost of goods sold) from \$6.49 million for the same period 2010. As a percentage of revenues, depreciation and amortization expenses increased to 2.5% for the six months ended June 30, 2011 from 2.2% for the same period in 2010. This percentage increase was primarily due to the decrease in revenues in the first half of 2011.

### *Income from operations*

Our income from operations decreased \$9.91 million, or 40.4%, to \$14.65 million for the three months ended June 30, 2011 as compared to \$24.56 million for the same period in 2010. As a percentage of revenues, income from operations decreased to 9.4% for the three months ended June 30, 2011 from 14.6% for the same period in 2010.

In the first six months of fiscal 2011, our income from operations decreased \$8.74 million, or 27.7%, to \$22.78 million as compared to \$31.52 million. As a percentage of revenues, income from operations decreased to 8.9% for the six months ended June 30, 2011 from 10.9% for the same period in 2010. The amount and percentage decrease in both the three and six month periods was mainly due to the significant increase in general and administrative expenses as discussed above.

The following table shows the different segments comprising our income (loss) from operations for the three and six months ended June 30, 2011 and 2010.

(All amounts in millions of U.S. dollars)

<b>Income (loss) from operations</b>	<b>Three months ended June 30,</b>					
	<b>2011</b>			<b>2010</b>		
Installation Segment	\$	31.72	216.5%	\$	32.80	133.6%
Manufacturing Segment		(1.60)	-10.9%		0.19	0.8%
Distribution Segment		(0.81)	-5.5%		(1.01)	-4.1%
Service Segment		(0.63)	-4.3%		0.21	0.8%
Corporate and others		(14.03)	-95.8%		(7.63)	-31.1%
<b>Total</b>	\$	<b>14.65</b>	<b>100.0%</b>	\$	<b>24.56</b>	<b>100.0%</b>

<b>Income (loss) from operations</b>	<b>Six months ended June 30,</b>					
	<b>2011</b>			<b>2010</b>		
Installation Segment	\$	56.25	246.9%	\$	52.54	166.7%
Manufacturing Segment		(4.39)	-19.3%		(0.86)	-2.7%
Distribution Segment		(1.78)	-7.8%		(1.67)	-5.3%
Service Segment		(1.48)	-6.5%		0.21	0.7%
Corporate and others		(25.82)	-113.3%		(18.70)	-59.4%
<b>Total</b>	\$	<b>22.78</b>	<b>100.0%</b>	\$	<b>31.52</b>	<b>100.0%</b>

Income from operations related to the Installation Segment decreased \$1.08 million or 3.3%, to \$31.72 million for the three months ended June 30, 2011, compared to \$32.80 million for the same period in 2010. This decrease was mainly because the number of installation projects we finished in the second quarter of 2011 was fewer than in the same period of 2010, and the increase in general and administrative expenses incurred in connection with the proposed Merger. In the first six months of fiscal 2011, income from operations related to the Installation Segment increased \$3.71 million, or 7.1%, to \$56.25 million, compared to \$52.54 million for the same period in 2010. This increase was mainly because the installation projects we finished in the first two quarters of 2011 generally had higher margins as compared to projects completed in the same periods in 2010.



Loss from operations related to the Manufacturing Segment was \$1.60 million for the three months ended June 30, 2011, as compared to income from operations related to the Manufacturing Segment of \$0.19 million for the same period in 2010. Loss from operations related to the Manufacturing Segment increased \$3.53 million, to \$4.39 million for the six months ended June 30, 2011, from \$0.86 million for the same period in 2010. In the first two quarters of 2011, we hired additional staff to meet the anticipated growth of the Manufacturing Segment.

Loss from operations related to the Distribution Segment decreased \$0.20 million, or 19.8%, to \$0.81 million for the three months ended June 30, 2011, as compared to \$1.01 million for the same period in 2010. Loss from operations related to the Distribution Segment was \$1.78 million for the six months ended June 30, 2011, increased from \$1.67 million for the same period in 2010. Such increase in loss from operations for the six months ended June 30, 2011 was mainly due to the decrease of revenues for the Distribution Segment.

Loss from operations related to the Service Segment was \$0.63 million for the three months ended June 30, 2011, as compared to income from operations of \$0.21 million in the second quarter of 2010. Loss from operations related to the Service Segment, which was established in the second quarter of 2010, was \$1.48 million for the six months ended June 30, 2011.

We also provide general corporate services to our segments. Costs attributable to these services were reported as corporate and other expenses. These costs included amortization, depreciation, and non-cash compensation for employees. Loss from operations related to the Corporate and others for the three months ended June 30, 2011 and 2010 was \$14.03 million and \$7.63 million, respectively. Loss from operations related to the Corporate and others for the six months ended June 30, 2011 and 2010 was \$25.82 million and \$18.70 million, respectively. The increase was mainly due to the increase in advertising expenses for corporation, additional staff, and professional expenses related to the proposed Merger transaction.

### ***Other income***

Our other income increased \$0.50 million, or 113.6%, to \$0.94 million for the three months ended June 30, 2011 from \$0.44 million for the same period in 2010. As a percentage of revenues, other income increased to 0.6% for the three months ended June 30, 2011 from 0.3% for the same period in 2010. Our other income increased \$0.90 million, or 116.9%, to \$1.67 million for the six months ended June 30, 2011 from \$0.77 million for the same period in 2010. As a percentage of revenues, other income for the six months ended June 30, 2010 was 0.7%, as compared to 0.3% for the same period in 2010. The dollar and percentage increase was mainly due to subsidies received from local governments in the first two quarters of 2011.

### ***Interest expense***

During the first half of 2011, we had borrowings under 6 long-term loans and 39 short-term loans from banks and 4 product financing arrangements from financial institutions. We incurred total interest expense of \$6.44 million and \$3.06 million for the three months ended June 30, 2011 and 2010, respectively. We incurred total interest expense of \$11.55 million and \$5.36 million for the six months ended June 30, 2011 and 2010, respectively. We also incurred \$0.30 million and \$0.82 million in interest during the three and six months ended June 30, 2011, respectively, in connection with our outstanding Tranche B Zero Coupon Guaranteed Senior Unsecured Notes (the Tranche B Notes ), as compared to \$0.73 million and \$1.68 million during the respective periods in 2010. The dollar increase in interest expense in the first half of 2011 was primarily due to the increase in the outstanding balance of our bank loans.

### ***Income before taxes***

Our income before taxes decreased \$12.79 million, or 58.3%, to \$9.15 million for the three months ended June 30, 2011 from \$21.94 million for the same period in 2010. As a percentage of revenues, income before taxes for the three months ended June 30, 2011 decreased to 5.9% from 13.1% for the same period in 2010. Our income before taxes decreased \$14.03 million, or 52.1%, to \$12.90 million for the six months ended June 30, 2011 from \$26.93 million for the same period in 2010. As a percentage of revenues, income before taxes for the six months ended June 30, 2011 decreased to 5.1% from 9.3% for the same period in 2010. Such dollar and percentage decrease was primarily due to the decrease in revenue and the increase in general and administrative expense and interest expense.

### ***Income Taxes***

China Security & Surveillance Technology, Inc. is subject to the United States federal income tax at a tax rate of 34%. No provision for income taxes in the United States has been made as China Security & Surveillance Technology, Inc. had no United States taxable income during the three and six months ended June 30, 2011 or 2010.

Our wholly-owned subsidiary Safetech was incorporated in the British Virgin Island and, under the current laws of the British Virgin Islands, is not subject to income taxes.

Our subsidiaries, Golden and Hongtianzhi are located in Shenzhen and Zhuhai DIT Digital Technology Limited is located in Zhuhai. They are each subject to an EIT rate of 24% in 2011. Chengfeng, Minking, Stonesonic, Tsingvision and Coson are each subject to an EIT rate of 15% in 2011 due to their high-technology company status. Jin Lin is

subject to an EIT rate of 12.5% in 2011 due to its high-technology company status. CSST PRC and Longhorn are located in Shenzhen and they are subject to an EIT rate of 12% in 2011 because they received the lower tax rate as high-technology companies. CSSI, CSSS, CSSD, HiEasy and Guanling are each subject to an EIT rate of 25% in 2011.

Our income taxes decreased \$0.95 million to \$3.18 million for the three months ended June 30, 2011 from \$4.13 million for the same period of 2010. Our income taxes decreased \$0.60 million to \$5.25 million for the six months ended June 30, 2010 from \$5.85 million for the same period of 2010. Such decrease was primarily due to the decrease in income before tax.

***Net income attributable to the Company***

Net income attributable to the Company decreased \$11.84 million, or 66.5%, to \$5.97 million for the three months ended June 30, 2011 from \$17.81 million for the same period in 2010. As a percentage of revenues, net income attributable to the Company decreased to 3.9% for the three months ended June 30, 2011 from 10.6% for the same period in 2010. Net income decreased \$13.43 million, or 63.7%, to \$7.65 million for the six months ended June 30, 2011 from \$21.08 million for the same period in 2010. As a percentage of revenues, net income attributable to the Company decreased to 3.0% for the six months ended June 30, 2011 from 7.3% for the same period in 2010. This dollar and percentage decrease was mainly due to the decrease in revenue and the increase in general and administrative expense and interest expenses in the first two quarters of 2011.

**Foreign Currency Translation Gains**

Our operating subsidiaries are located in China. Our operating subsidiaries purchase substantially all products and render all services in China, and receive payment from customers in China using RMB as the functional currency. We do not engage in currency hedging.

On July 21, 2005, China reformed its foreign currency exchange policy, revalued the RMB by 2.1 percent and allowed the RMB to appreciate as much as 0.3 percent per day against the U.S. dollar. As a result, we implemented different exchange rates in translating RMB into U.S. dollars in our financial statements for the first and second quarter of 2011 and 2010.

For the three months ended June 30, 2011, we utilized the exchange rates of 6.47, 6.49, and 8.04 in calculating the assets and liabilities, revenue and expenses, and equity, respectively. For the three months ended June 31, 2010, we implemented the exchange rates of 6.79, 6.82, and 8.04 in calculating the assets and liabilities, revenue and expenses, and equity, respectively. We incurred a foreign currency translation gain of \$9.84 million and \$16.67 million for the three and six months ended June 30, 2011, respectively, as compared to \$3.20 million and \$3.32 million for the respective periods in 2010.

**Liquidity and Capital Resources****General**

As of June 30, 2011 and December 31, 2010, we had cash and cash equivalents of \$144.21 million and \$65.63 million, respectively. The following table sets forth a summary of our net cash flows for the periods indicated.

**CASH FLOW**

(All amounts in millions of U.S. dollars)

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Net cash used in operating activities	\$ (120.12)	\$ (56.46)
Net cash provided by (used in) investing activities	13.23	(32.30)
Net cash provided by financing activities	182.04	140.51
Effect of exchange rate changes on cash	3.44	1.84
Net cash inflow	\$ 78.59	\$ 53.59

**Operating Activities**

Net cash used in operating activities for the six months ended June 30, 2011 totaled \$120.12 million, which increased from \$56.46 million for the same period in 2010. The increase in net cash used in operating activities in the first half of 2011, was primarily due to the increase in prepayments and deposits, as well as advances to suppliers and subcontractors.

**Investing Activities**

Our main uses of cash for investing activities during the six months ended June 30, 2011 and 2010, were for acquisitions of plant and equipment and deposits for the acquisition of subsidiaries.

Net cash provided by investing activities for the six months ended June 30, 2011 was \$13.23 million, as compared to net cash used in investing activities of \$32.30 million in the same period of 2010. This increase in net cash provided by investing activities was primarily due to the net cash provided by deposits refunded for business acquisitions, properties and intangible assets in the first half of 2011.

***Financing Activities***

Net cash provided by financing activities in the six months ended June 30, 2011 totaled \$182.04 million as compared to \$140.51 million in the same period of 2010. The increase in net cash provided by financing activities was mainly attributable to proceeds from additional bank loans obtained in the first two quarters of 2011. For details of the loan facilities, please refer to the [Loan Facilities](#) section below.

**Loan Facilities****a) Notes payable**

As of June 30, 2011, the amount, maturity date and original term of each of our bank loans were as follows:

(All amounts in millions of U.S. dollars)

<b>Lender</b>	<b>Amount*</b>	<b>Maturity Date</b>	<b>Original Term</b>
China Development Bank	\$ 200.00	February 2014	3 years
China Development Bank	50.00	October 2013	3 years
Bank of Jiangsu	0.77	June 2012	1 year
Guangdong Development Bank	7.66	June 2012	1 year
China Everbright Bank	2.47	December 2011	6 months
Bank of Jiangsu	2.32	May 2012	1 year
Shanghai Pudong Development Bank	12.36	May 2012	1 year
Shanghai Pudong Development Bank	12.36	April 2012	1 year
Bank of Jiangsu	7.73	April 2012	1 year
Industrial and Commercial Bank of China	6.18	March 2012	1 year
Sociate Generale	4.17	September 2011	6 months
China Merchants Bank	4.87	September 2011	6 months
China Construction Bank	7.73	March 2012	1 year
Guangdong Development Bank	18.70	March 2012	1 year
China Merchants Bank	9.12	November 2012	2 years
Industrial and Commercial Bank of China	15.46	January 2012	1 year
China Zheshang Bank	3.09	August 2011	1 year
China Merchants Bank	30.93	January 2021	10 years
China Merchants Bank	1.55	November 2012	2 years
Bank of China	10.98	December 2011	1 year
Bank of China	10.98	December 2011	1 year
China Merchants Bank	10.82	November 2012	1 year

Industrial and Commercial Bank of China	15.46	December 2011	1 year
Industrial and Commercial Bank of China	7.88	November 2011	1 year
China Merchants Bank	1.93	October 2011	1 year
Shenzhen Development Bank	6.18	August 2011	1 year
China Everbright Bank	6.18	July 2011	1 year
Industrial and Commercial Bank of China	8.44	July 2011	1 year
China Construction Bank	4.64	July 2011	1 year
Industrial and Commercial Bank of China (Asia)	10.00	July 2011	1 year
Total	\$ 490.96		

\* Calculated on the basis that \$1 = RMB6.47.

We have entered the following bank loans. The terms of bank loans that we typically enter into require collateral for the loans. Collateral is usually defined in the agreements as buildings and land use rights.

On March 1, 2011, we entered into a term loan facility agreement with the China Development Bank Corporation Hong Kong Branch ( CDB ), pursuant to which CDB agreed to make available to the Company a term loan facility in an aggregate principal amount of up to \$200.00 million, subject to terms and conditions of the agreement. We borrowed a total of \$200.00 million on March 1, 2011 under the facility, with an annual interest rate of 3% per annum over the applicable six-month London Inter Bank Offered Rate (3.40% as of June 30, 2011). The loan under the facility will mature on the third anniversary of the first date when the facility is utilized by us with 50% of the principal due in August 2013 and the remaining 50% due in February 2014. Pursuant to the term loan facility agreement, if our chairman and CEO, Mr. Guoshen Tu, ceases to be the beneficial owner of at least 10% of our outstanding capital stock, the facility may be cancelled and all outstanding loans under the facility may become immediately due and payable with no less than 30 days notice. As of June 30, 2011, this condition was satisfied, and management believes that we are in compliance with all terms and conditions of the term loan facility agreement.

In October 2010, we entered into a term loan facility agreement with CDB, pursuant to which CDB agreed to make available to us a term loan facility in an aggregate principal amount of up to \$50.00 million, subject to terms and conditions of the agreement. We borrowed a total of \$50.00 million on October 29, 2010 under the facility, with an annual interest rate of 3% per annum over the applicable six-month London Inter Bank Offered Rate (3.40% as of June 30, 2011). The loan under the facility is due in October 2013. Pursuant to the term loan facility agreement, if Mr. Guoshen Tu ceases to be the beneficial owner of at least 10% of our outstanding capital stock, the facility may be cancelled and all outstanding amounts due under this facility may become immediately due and payable with no less than 30 days notice. As of June 30, 2011, this condition was satisfied, and management believes we are in compliance with all terms and conditions of the term loan facility agreement.

On June 17, 2011, we entered into a loan agreement with Bank of Jiangsu. We borrowed RMB5.00 million (approximately \$0.77 million) with an interest rate equal to the 115% of the 12 month s benchmark lending rate of the People s Bank of China (7.26% as of June 30, 2011). The loan is due in June 2012. The loan is guaranteed by our CEO and one of our subsidiaries and collateralized by the properties and land use rights of two subsidiaries.

On June 14, 2011, the Company entered into a loan agreement with Guangdong Development Bank. The Company borrowed RMB49.60 million (approximately \$7.66 million) with an annual interest rate equal to 110% of the 12 months benchmark lending rate of the People s Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in June 2012 and guaranteed by the CEO and a subsidiary of the Company.

On June 13, 2011, we entered into a loan agreement with China Everbright Bank Co., Ltd. We borrowed RMB16.00 million (approximately \$2.47 million) with an interest rate equal to 5.27% as of June 30, 2011, with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by one of our subsidiaries and collateralized by a restricted cash amount of RMB16.00 million (approximately \$2.47 million) of one of our subsidiaries.

On May 27, 2011, we entered into a loan agreement with Bank of Jiangsu. We borrowed RMB15.00 million (approximately \$2.32 million) with an interest rate equal to the 110% of the 12 month s benchmark lending rate of the People s Bank of China (6.94% as of June 30, 2011). The loan is due in May 2012. The loan is guaranteed by our CEO and one of our subsidiaries and collateralized by the properties and land use rights of two subsidiaries.

On May 3, 2011 we entered into a loan agreement with Shanghai Pudong Development Bank. We borrowed RMB80.00 million (approximately \$12.36 million) with an interest rate equal to 108% of the 12 month s benchmark lending rate of the People s Bank of China (6.81% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in May 2012. The loan is guaranteed by our CEO and one of our subsidiaries and collateralized by the properties and land use rights of one of our subsidiaries.

On April 29, 2011, we entered into a loan agreement with Shanghai Pudong Development Bank. We borrowed RMB80.00 million (approximately \$12.36 million) with an interest rate equal to 108% of the 12 month s benchmark lending rate of the People s Bank of China (6.81% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in April 2012. The loan is guaranteed by our CEO and collateralized by the properties and land use rights of one of our subsidiaries.

On April 20, 2011, we entered into a loan agreement with Bank of Jiangsu. We borrowed RMB50.00 million (approximately \$7.73 million) with an interest rate equal to 110% of the 12 month s benchmark lending rate of the People s Bank of China (6.94% as of June 30, 2011). The loan is due in April 2012. The loan is guaranteed by our CEO and one of our subsidiaries and collateralized by the properties and land use rights of two subsidiaries.

On April 1, 2011, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB27.27 million (approximately \$4.21 million) on April 1, 2011 and RMB12.77 million (approximately \$1.97 million) on May 17, 2011 with interest rate equal to 12 month s benchmark lending rate of the People s Bank of China (6.31% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in March 2012 and guaranteed by three of our subsidiaries and is collateralized by the property and land use right of a subsidiary.

On April 1, 2011, we entered into a loan agreement with Societe Generale with loan facility up to RMB27.00 million (approximately \$4.17 million), and in the same month, we withdrew RMB27.00 million (approximately \$4.17 million) from the loan facility with annual interest rates ranging from 6.56% to 6.84% and are all due in October 2011. The loans are guaranteed by one of our subsidiary.

On March 24, 2011, we entered into a loan agreement with China Merchants Bank. We borrowed RMB31.50 million (approximately \$4.87 million) with an annual interest rate equal to the 1 to 6 month s benchmark lending rate of the



People's Bank of China (5.85% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in September 2011 and guaranteed by one of our subsidiaries.

On March 21, 2011, we entered into a loan agreement with China Construction Bank. We borrowed RMB50.00 million (approximately \$7.73 million) with an annual interest rate equal to 7.20%, with interest payable on the 20th of each month. The loan is due in March 2012. The loan is guaranteed by our CEO and two of our subsidiaries and collateralized by the property of a subsidiary.

On March 16, 2011, we entered into a loan agreement with Guangdong Development Bank. We borrowed RMB121.00 million (approximately \$18.70 million) with an annual interest rate equal to 105% of the 1 to 6 month benchmark lending rate of the People's Bank of China (6.14% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in March 2012 and collateralized by a restricted cash amount of \$20.00 million of one of our subsidiaries.

On February 9, 2011, we entered into a loan agreement with Societe Generale. We borrowed RMB27.00 million (approximately \$4.17 million) with an annual interest rate equal to 9.10%, with interest payable on the due date of the loan. The loan was due and repaid in March 2011, and guaranteed by one of our subsidiaries.

On February 1, 2011, we entered into a loan agreement with China Merchants Bank. We borrowed RMB59.00 million (approximately \$9.12 million) with an annual interest rate equal to 105% of the 1 to 3 year benchmark lending rate of the People's Bank of China (6.72% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2012. The loan is guaranteed by our CEO, his wife and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On January 31, 2011, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB100.04 million (approximately \$15.46 million) with an annual interest rate equal to 95% of the 12 month benchmark lending rate of the People's Bank of China (5.99% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in January 2012 and guaranteed by four of our subsidiaries.

On January 12, 2011, we entered into a loan agreement with China Zheshang Bank. We borrowed RMB20.00 million (approximately \$3.09 million) with an annual interest rate equal to 120% of the 6 to 12 month benchmark lending rate of the People's Bank of China (7.57% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in August 2011 and guaranteed by our CEO and two of our subsidiaries.

On January 10, 2011, we entered into a loan agreement with China Merchants Bank. We borrowed RMB40.00 million (approximately \$6.18 million) on January 10, 2011, and RMB169.34 million (approximately \$26.16 million) on February 9, 2011 with an annual interest rate equal to 105% of the 5 to 10 year benchmark lending rate of the People's Bank of China (7.14% as of June 30, 2011), with principal and interest payable in each quarter. In March and June 2011, we repaid principal of the loan in the amount of RMB5.44 million (approximately \$0.84 million) and RMB3.70 million (approximately \$0.57 million) in accordance with the terms of the loan, respectively. The final maturity of the loan is January 2021. The loan is guaranteed by Shenzhen Zhonghe Industrial Limited, an independent third party, and is secured by the rights of properties currently under construction which will be acquired by us upon their completion.

On January 4, 2011, we entered into a loan agreement with China Merchants Bank. We borrowed RMB10.00 million (approximately \$1.55 million) with an annual interest rate equal to 105% of the 1 to 3 year benchmark lending rate of the People's Bank of China (6.72% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2012. The loan is guaranteed by our CEO, his wife and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On December 29, 2010, we entered into a loan agreement with Bank of China. We borrowed RMB71.10 million (approximately \$10.98 million) with an annual interest rate equal to 5.15%, with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by our CEO and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On December 24, 2010, we entered into a loan agreement with Bank of China. We borrowed RMB71.10 million (approximately \$10.98 million) with an annual interest rate equal to 5.15%, with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by our CEO and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On December 10, 2010, we entered into a loan agreement with Shanghai Pudong Development Bank. We borrowed RMB66.00 million (approximately \$10.20 million) with an annual interest rate equal to the 6 month's benchmark lending rate of the People's Bank of China (5.85% as of June 30, 2011), with interest payable on the 20th of each month. The loan was due in June 2011 and collateralized by a cash deposit of Whitehorse Technology Limited, a company wholly-owned by our CEO. We repaid RMB6.65 million (approximately \$1.03 million), RMB6.60 million (approximately \$1.02 million), RMB20.25 million (approximately \$3.13 million) and RMB33.25 million (approximately \$5.02 million) in January, March, April and June 2011, respectively.

On December 2, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB70.00 million (approximately \$10.82 million) with an annual interest rate equal to 105% of the 1 to 3 year's benchmark lending rate of the People's Bank of China (6.72% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2012. The loan is guaranteed by our CEO, his wife and one of our subsidiaries, and collateralized by the property and land use rights of a subsidiary.

On November 19, 2010, we entered into a loan agreement with Industrial and Commercial Bank of China. We borrowed RMB30.00 million (approximately \$4.64 million) on December 21, 2010, RMB30.00 million (approximately \$4.64 million) on December 29, 2010 and RMB40.00 million (approximately \$6.18 million) on January 31, 2011 with an annual interest equal to 95% of the 12 month's benchmark lending rate of the People's Bank of China (5.99% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in December 2011. The loan is guaranteed by three of our subsidiaries and collateralized by the property of a subsidiary.

On November 17, 2010, we entered into a loan agreement with Bank of China. We borrowed RMB48.60 million (approximately \$7.51 million) with an annual interest rate equal to 5.15%, with interest payable on the 20th of each month. The loan was due and repaid in May 2011. The loan was guaranteed by our CEO and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On October 29, 2010, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB51.00 million (approximately \$7.88 million) with an annual interest rate equal to 95% of the 12 month's benchmark lending rate of the People's Bank of China (5.99% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in November 2011. The loan is guaranteed by three of our subsidiaries and collateralized by the property of a subsidiary.

On October 18, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB25.00 million (approximately \$3.86 million) with an annual interest equal to 110% of the 12 month's benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in October 2011. We repaid RMB12.50 million (approximately \$1.93 million) in April 2011. The loan is guaranteed by our Chief Operating Officer, our CEO and his wife.

On August 18, 2010, we entered into a loan agreement with Shenzhen Development Bank. We borrowed RMB40.00 million (approximately \$6.18 million) with an annual interest rate equal to the 12 month's benchmark lending rate of the People's Bank of China (6.31% as of June 30, 2011), with interest payable on the 20th of each month. The loan is due in August 2011. The loan is guaranteed by our CEO and two of our subsidiaries and collateralized by the property of a subsidiary.

On August 9, 2010, we entered into a loan agreement with Societe Generale. We borrowed RMB27.00 million (approximately \$4.17 million) with an annual interest rate equal to 5.35%, with interest payable on the due date of the loan. The loan was due and repaid in February 2011. The loan was guaranteed by one of our subsidiaries.

On July 26, 2010, we entered into a loan agreement with China Everbright Bank Co., Ltd. We borrowed RMB40.00 million (approximately \$6.18 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan was due and repaid in July 2011 and guaranteed by our CEO, one of our subsidiaries and Chuang Guan.

On July 21, 2010, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB54.60 million (approximately \$8.44 million) with an annual interest rate equal to 12 month's benchmark lending rate of the People's Bank of China (6.31% as of June 30, 2011), with interest payable on the 20th of each month. The loan was due and repaid in July 2011. The loan is guaranteed by three of our subsidiaries and collateralized by the property of a subsidiary.

On July 15, 2010, we entered into a loan agreement with China Construction Bank. We borrowed RMB30.00 million (approximately \$4.64 million) with an annual interest rate equal to 110% of the 12 month's benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan was due and repaid in July 2011 and collateralized by the property of one of our subsidiaries.

On July 1, 2010, we entered into a loan agreement with Guangdong Development Bank. We borrowed RMB49.60 million (approximately \$7.66 million) with an annual interest rate equal to 110% of the 12 month's benchmark lending rate of the People's Bank of China (6.94% as of June 30, 2011), with interest payable on the 20th of each month. The loan was guaranteed by our CEO and one of our subsidiaries. The loan was due and repaid in June 2011.

On June 18, 2010, we entered into a loan agreement with Industrial and Commercial Bank of China (Asia) Limited. We borrowed \$8.00 million and \$2.00 million on July 15, 2010 and August 12, 2010, respectively, with an effective interest rate at 3% per annum over the applicable one year London Inter Bank Offered Rate (3.73% at June 30, 2011), with interest payable on the due date of the loan. Interest payable is calculated on the basis of the actual number of days elapsed and a 360-day year. The loan was due in July 2011 and extended to July 2012 under a supplementary agreement signed on June 23, 2011. The loan is guaranteed by our CEO and collateralized by fixed assets of one of our subsidiaries and the shares of one of our subsidiaries.

On April 16, 2010, we entered into a loan agreement with Shanghai Pudong Development Bank. We borrowed RMB80.00 million (approximately \$12.36 million) with an annual interest rate equal to 6.06%, with interest payable on the 20th of each month. The loan was due and repaid in April 2011. The loan was guaranteed by our CEO and one of our subsidiaries and collateralized by the properties and land use rights of a subsidiary.

On April 15, 2010, we entered into a loan agreement with Shanghai Pudong Development Bank. We borrowed RMB80.00 million (approximately \$12.36 million) with an annual interest rate equal to 6.06%, with interest payable on the 20th of each month. The loan was due and repaid in April 2011. The loan was guaranteed by our CEO and collateralized by the properties and land use rights of one of our subsidiaries.

On March 31, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB50.00 million (approximately \$7.73 million) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by our CEO, his wife and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On March 25, 2010, we entered into a loan agreement with China Citic Bank. We borrowed RMB90.00 million (approximately \$13.91 million) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by our CEO, his wife and one of our subsidiaries and collateralized by the properties of two of our subsidiaries.

On March 24, 2010, we entered into a loan agreement with China Citic Bank. We borrowed RMB60.00 million (approximately \$9.27 million) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by our CEO, his wife and one of our subsidiaries, and collateralized by the properties of two of our subsidiaries.

On March 4, 2010, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB31.00 million (approximately \$4.79 million) with an annual interest rate equal to 5.23%, with interest payable on the 20th of each month. The loan was due in March 2011, but repaid in February 2011. The loan was guaranteed by three of our subsidiaries and collateralized by the property of a subsidiary.

On March 4, 2010, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB39.00 million (approximately \$6.03 million) with an annual interest rate equal to 5.23%, with interest payable on the 20th of each month. The loan was due in March 2011, but repaid in January 2011. The loan was guaranteed by three of our subsidiaries and collateralized by the property of a subsidiary.

On March 3, 2010, we entered into a loan agreement with China Construction Bank. We borrowed RMB50.00 million (approximately \$7.73 million) with an annual interest rate equal to 6.10%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by our CEO and one of our subsidiaries and collateralized by the property of a subsidiary.

On March 2, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB41.00 million (approximately \$6.34 million) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in March 2011. The loan was guaranteed by our CEO, his wife and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On February 3, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB59.00 million (approximately \$9.12 million) with an annual interest rate equal to 5.81%, with interest payable on the 20th of each month. The loan was due and repaid in February 2011. The loan was guaranteed by our CEO, his wife and one of our subsidiaries and collateralized by the property and land use rights of a subsidiary.

On January 26, 2010, we entered into a loan agreement with the Industrial and Commercial Bank of China. We borrowed RMB100.00 million (approximately \$15.45 million) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan was due in January 2011. We repaid RMB80.00 million (approximately \$12.36 million) and RMB 20.00 million (approximately \$3.09 million) in June 2010 and January 2011, respectively. The loan was guaranteed by our CEO.

**b) Product financing arrangements**

As of June 30, 2011, the amount, maturity date and original term of each of our obligations under product financing arrangements were as follows:

(All amounts in millions of U.S. dollars)

<b>Lender</b>	<b>Amount *</b>	<b>Maturity Date</b>	<b>Original Term</b>
A Financial Institution	\$ 5.36	June 2013 September	3 years
A Financial Institution	0.50	2013 September	4 years
A Financial Institution	3.46	2012	3 years
Total	\$ 9.32		

\* Calculated on the basis that \$ 1 = RMB6.47

In June 2010, we entered into product financing agreements with a financial institution. Under the terms of the agreements, we agreed to pay an annual interest rate of 8.23% on inventory financings. We borrowed RMB50 million (approximately \$7.73 million). The loans expire in June 2013, and payments of principal and interest are due at the end of each quarter.

In September 2009, we entered into product financing agreements with a financial institution. Under the terms of the agreements, we agreed to pay an annual interest rate of 8.46% on inventory financings. We borrowed RMB50 million (approximately \$7.73 million). The loans expire in September 2012, and payments of principal and interest are due at the end of each quarter.

In February 2009, we entered into product financing agreements with a financial institution. Under the terms of the agreements, we agreed to pay an annual interest rate of 10.5% on inventory financings. We borrowed RMB7.11 million (approximately \$1.10 million). The loans expire in September 2013, and payments of principal and interest are due at the end of each quarter.

***c) Guaranteed senior unsecured notes payable***

As of June 30, 2011, we had outstanding the Tranche B Notes. The Tranche B Notes have a principal amount of \$84.00 million, zero coupon interest and a fair value of \$78.44 million, resulting in a debt discount of \$5.56 million and an effective interest rate of approximately 5%. The Tranche B Notes mature on September 2, 2012. We are to repay the principal amount in six consecutive semi-annual installments, that began on March 2, 2010, with 46%, 46%, and 8% of the principal amount to be repaid in the first, second and third year, respectively. The Tranche B Notes are not convertible. We will be entitled to redeem the Tranche B Notes at any time with no premium or penalty at a redemption price equal to 100% of the principal amount of the Tranche B Notes to be redeemed, plus default interest, if any. The Tranche B Notes are guaranteed by our significant subsidiaries to the extent permitted under applicable laws. We repaid \$19.32 million of the principal on the Tranche B Notes in March 2011.

***d) Others***

The Kunming Safe City project consisted of two stages - Stage I and Stage II. Stage I was completed in December 2008, and Stage II was completed in March 2009. All receivables totaling RMB123 million (approximately \$18 million) related to Stage I were sold to Industrial and Commercial Bank of China ( ICBC ) in March 2009 for RMB113 million (approximately \$16.5 million). This amount was fully collected from ICBC in March 2009. Stage II receivables were RMB86 million (\$12.6 million), of which RMB11.33 million (approximately \$1.73 million) was outstanding as of December 31, 2010. The remaining receivables from the Kunming Municipal Government were fully collected in February 2011.

On October 3, 2006, we signed a banking facility agreement with China Construction Bank under which the bank agreed to provide a new receivable-based facility to support our efforts in securing new contracts relating to the Safe City Project initiative, also known as Plan 3111. This facility will provide three possible financing options: (1) the government takes a loan from the bank to finance the project; (2) we sell the accounts receivable to the bank, 85% of the total account receivables value will be paid by the bank to us and the remaining 15% will be collected by the bank from the government; from the 15% collected from the government, the bank will retain certain finance charges and pay the remainder over to us; or (3) we take a loan from the bank to finance the project. As part of this agreement, we will make periodic deposits with the bank, which, depending upon the specific project, will provide a maximum factoring capacity of five to ten times the amount deposited. None of the facility has been drawn down as of the date of this report.

***Loan facility liquidity requirements***



In the remaining six months of 2011, we have approximately \$98.49 million in bank loans that will mature. We believe we will be able to pay all obligations as they become due. As some of our loans become due, we may elect to renew or refinance, rather than repay, the indebtedness. However, there is no assurance that additional financing will become available on terms acceptable to us. We believe that we will have the ability to refinance our indebtedness when and if we elect to do so. While we currently are not in a position to know the terms of such refinancing, we expect to refinance our indebtedness at prevailing market rates and on prevailing market terms. We are exposed to a variety of risks associated with short-term borrowings including adverse fluctuations in fixed interest rates for short-term borrowings and unfavorable increases in variable interest rates, potential inability to service our short term indebtedness through cash flow from operations and the overall reduction of credit in the current economic environment.

We believe that our currently available working capital, after receiving the aggregate proceeds of our capital raising activities, the credit facilities referred to above and the anticipated bank loans, should be adequate to sustain our operations at our current levels through at least the next twelve months.

Our liquidity and working capital may be affected by the substantial amount of our outstanding short-term loans, which represent our primary source of financing in China. Depending on the level of cash used in our operating activities and the level of our indebtedness, (i) it may become more difficult for us to satisfy our existing or future liabilities or obligations, which could in turn result in an event of default on such obligations, (ii) we may have to dedicate a substantial portion of our cash flows from borrowings to our operating activities and to debt service payments, thereby reducing the availability of cash for working capital and capital expenditures, acquisitions, general corporate purposes or other purposes, (iii) our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes may become impaired, (iv) our ability to withstand a downturn in our business, the industry in which we operate or the economy generally may be diminished, (v) we may experience limited flexibility in planning for, or reacting to, changes in our business and the industry in which we operate and (vi) we may find ourselves at a competitive disadvantage compared to competitors that have proportionately less debt. If we are unable to meet our debt service obligations, we could be forced to restructure or refinance our indebtedness, seek additional equity capital or sell assets. We may be unable to obtain financing or sell assets on satisfactory terms, or at all, which could cause us to default on our debt service obligations and be subject to foreclosure on such loans. Additionally, we could incur additional indebtedness in the future and, if new debt is added to our current debt levels, the risks above could intensify.

If the Merger is consummated, subsequent to the Merger we expect to be substantially leveraged. Our liquidity requirements will be significantly changed, primarily due to the addition of debt service requirements to our existing cash needs discussed above.

### ***Obligations under Material Contracts***

Below is a table setting forth our material contractual obligations as of June 30, 2011:

(All amounts in millions of U.S. dollars)

	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Debt Obligations	\$ 526.31	\$ 222.71	\$ 280.57	\$ 6.20	\$ 16.83
Operating Lease Obligations	2.28	1.91	0.37	--	--
Total	\$ 528.59	\$ 224.62	\$ 280.94	\$ 6.20	\$ 16.83

### ***Critical Accounting Policies***

The preparation of consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires our management to make assumptions, estimates and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. We consider our critical accounting policies to be those that require the most significant judgments and estimates in the preparation of financial statements, including the following:

- ***Use of Estimates*** - The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Management makes these estimates using the best information available at the time the estimates are made; however, actual results could differ materially from those estimates.
- ***Fair Value Measurement*** - We utilize a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

At June 30, 2011, we had no financial assets or liabilities subject to recurring fair value measurements.

Our financial instruments include cash, accounts receivable, other receivables, accounts and bills payable, notes payable, obligations under product financing arrangements and guaranteed senior unsecured notes

payable. Management estimates that the carrying amounts of the non-related party financial instruments approximate their fair values due to their short-term nature and/or market rates of interest currently available to us.

- **Accounts Receivable** Financial instruments that potentially subject us to concentration of credit risk consist primarily of trade accounts receivable. We extend credit to our customers in the normal course of business when considered appropriate. Our credit terms in general are from 30 to 330 days, dependent upon the segment. We perform ongoing credit evaluations and generally do not require collateral. We maintain an allowance for potential credit losses based upon our loss history and its aging analysis. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We review the allowance for doubtful accounts each reporting period based on a detailed analysis of our accounts receivable. In the analysis, we primarily consider the age of the customer's receivable and also consider the creditworthiness of the customer, the economic conditions of the customer's industry, and general economic conditions, among other factors. If any of these factors change, we may also change our original estimates, which could impact the level of our future allowance for doubtful accounts.

If payment is not made timely, we contact the customer to try to obtain payment. Once all collection efforts are exhausted, the receivable is written off against the allowance for doubtful accounts.

From time to time, we enter into receivable factoring agreements. We account for such arrangements under ASC 860 *Transfer and Servicing*. These arrangements are without recourse, the receivables are isolated from us, the transferee has the right to pledge or exchange the receivables, and we do not maintain effective control over the receivables. Therefore, these arrangements satisfy the conditions to be accounted for as a sale and we recognize any gain or loss in earnings.

- **Inventories** - Inventories are stated at the lower of cost, determined on a weighted average basis, and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

When inventories are sold, their carrying amount is charged to expense in the period in which the revenue is recognized.

Write-downs for declines in net realizable value or for losses of inventories are recognized as an expense in the period the impairment or loss occurs.

- **Goodwill** - Goodwill represents the excess of the purchase price over the net of the fair value of the identifiable tangible and intangible assets acquired and the fair value of liabilities assumed in acquisitions. ASC 350-30-50, *Goodwill and Other Intangible Assets* requires the testing of goodwill and indefinite-lived intangible assets for impairment at least annually. We test goodwill for impairment in the fourth quarter each year.

Under applicable accounting guidance, the goodwill impairment analysis is a two-step test. The first step of the goodwill impairment test involves comparing the fair value of each reporting unit with its carrying amount including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired; however, if the carrying amount of the reporting unit exceeds its fair value, the second step must be performed to measure potential impairment.

The second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated possible impairment. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, which is the excess of the fair value of the reporting unit, as determined in the first step, over the aggregate fair values of the assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. The adjustments to measure the assets, liabilities and intangibles at fair value are for the purpose of measuring the implied fair value of goodwill, and such adjustments are not reflected in the consolidated balance sheet. If the implied fair value of goodwill exceeds the goodwill assigned to the reporting unit, there is no impairment. If the goodwill

assigned to a reporting unit exceeds the implied fair value of goodwill, an impairment charge is recorded for the excess.

- **Revenue Recognition** - Revenue from sales of surveillance and safety products and systems are recognized in accordance with Staff Accounting Bulletin ( SAB ) No. 104: *Revenue Recognition* and related interpretations. Revenues are recognized when the following criteria are met:

(i) Persuasive evidence of an arrangement exists We require evidence of an agreement with a customer specifying the terms and conditions of the products to be delivered typically in the form of a signed contract or purchase order;

(ii) Delivery has occurred For product sales, delivery generally takes place when titles to the products are shipped to or accepted by the customer;

(iii) The fee is fixed or determinable Fees are fixed or determinable based on the contract or purchase order terms; and

(iv) Collection is probable We perform a credit review of all customers with significant transactions to determine whether a customer is creditworthy and collection is probable.

All revenues are recognized net of any taxes collected from customers and subsequently remitted to governmental authorities.

Product sales contracts generally provide a one to three-year product warranty to customers from the date of purchase. We estimate the costs of satisfying warranty claims based on an analysis of past experience and provide for the future claims in the period the revenue is recognized.

We derive a significant portion of our revenue from the supply and installation of surveillance and safety equipment and the two deliverables do not meet the separation criteria under ASC 605-25 Multiple-Element Arrangements. Installation segment contracts vary in terms of contract amount and period of performance. The performance period for short-term contracts is usually between three and six months. The period of performance for long-term contracts is typically between a year and 36 months. Long-term contracts generally are entered into with municipalities, cities, provinces, or their affiliates located in China. These long-term contracts are further defined by agreed-upon detail specifications that outline defined stages. Completion of a defined stage represents basic service and products delivered, such as the installation of specified surveillance and safety systems in defined locations within the project area. Stages are typically planned to be completed over defined three to six-month periods. Each stage represents a discrete, defined phase of the total contract, for which completion can be readily determined. At the completion of a stage, and upon customer inspection, verification and acceptance of the work performed, we recognize the fixed price per stage as revenue. At the time of stage completion, we consider the title to work performed passing to the customer. Other than a warranty reserve, discussed below, we have no further obligations to the customer for a completed stage.

The use of contract accounting requires significant judgment in estimating total contract pricing and costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, anticipated increases in wages and prices for subcontractor services and materials, and the availability of subcontractor services and materials. Our estimates are based upon the professional knowledge and experience of its engineers, program managers and other personnel, who review each long-term contract continually to assess the contract's schedule, performance, technical matters and estimated cost at completion. Our risk on fixed-price contracts is that if estimates to complete the contract change from one period to the next, profit levels will vary from period to period.

Approximately 1% of contract installation revenue is deferred for the repair work during the one-year warranty period. We carefully monitor the warranty work requested by our customers, and has determined that minimal warranty work has historically been requested to be performed. We believe that this 1% warranty reserve is adequate.

Repairs and maintenance service revenue is recognized when the service is performed.

We derive a portion of our revenue from one-year software upgrades. These services are typical post-contract service ( PCS ) arrangements according to ASC 985-605-25 Revenue Recognition . Under this guidance, PCS revenue may be recognized together with the initial licensing fee on delivery of the software if all of the following conditions are met:

(i) The PCS fee is included with the initial licensing fee;

- (ii) The PCS included with the initial license is for one year or less;
- (iii) The estimated cost of providing PCS during the arrangement is insignificant; and
- (iv) Unspecified upgrades/enhancements offered during PCS arrangements historically have been and are expected to continue to be minimal and infrequent.

Revenue from surveillance and safety system one-year software upgrades is recognized when delivery occurs and the risk of ownership passes to the customers, as we believe it meets the conditions above related to its PCS arrangements and is therefore in compliance with the applicable accounting guidance.

- **Income taxes** - We account for income taxes using the asset and liability method prescribed by ASC 740 *Income Taxes* . Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect in the year in which the differences are expected to reverse. We record a valuation allowance to offset deferred tax assets if based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of the deferred tax assets will not be realized. The effect on deferred taxes of a change in tax rates is recognized as income or loss in the period that includes the enactment date.

We do not have any material unrecognized tax benefits.

We file income tax returns with the relevant government authorities in the U.S. and the PRC. We were not subject to U.S. federal tax examinations for years before 2007. We do not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We do not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized. Our effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses, and preferential tax treatment.

- **Earnings Per Share** - ASC 260 Earnings Per Share , requires dual presentation of basic and diluted earnings per share ( EPS ) with a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. Basic EPS excludes dilution. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earnings per basic share of common stock is based on the weighted average number of shares of common stock outstanding during each respective period. Earnings per diluted share of common stock adds to basic weighted shares the weighted average number of shares issuable under contingent issuances, stock options and warrants outstanding during each respective period, using the if-converted or treasury-stock methods.

For purposes of the computation of net income per share, shares issued in connection with acquisitions that are returnable are considered contingently returnable shares. These contingently returnable shares, although classified as issued and outstanding, are not included in basic weighted average number of shares until all necessary conditions are met that no longer cause the shares to be contingently returnable. These contingently returnable shares are included in diluted weighted average number of shares as of the beginning of the period in which the conditions were satisfied (or as of the date of the agreement, if later).

Unvested restricted shares issued (share-based compensation) under the Equity Incentive Plan are not included in basic weighted average number of shares but are considered to be outstanding as of the grant date for purposes of computing diluted earnings per share even though the shares are subject to vesting requirements.

For additional Critical Accounting Policies, please see Item 7, Management's Discussion and Analysis of Results of Operations and Financial Condition in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as amended, for a discussion of our critical accounting policies.

### ***Recently Issued and Adopted Accounting Pronouncements***

#### **Business Combinations**

*(Included in ASC 805 Business Combination, previously SFAS No. 141(R))*

In December 2010, the Financial Accounting Standards Board (FASB ) issued Accounting Standards Update (ASU ) No. 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. This ASU specifies that when financial statements are presented, the revenue and earnings of the combined entity should be disclosed as though the business combination 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 for business combinations with acquisition dates on or after January 1, 2011. The adoption of this update did not have an



impact on our consolidated financial statements.

Goodwill

(Included in ASC 350 *Intangibles-Goodwill and Other* )

In December 2010, the FASB issued ASU No.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 requires that reporting units with zero or negative carrying amount perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. ASU 2010-28 is effective for us beginning with this interim period. The adoption of this update did not have an impact on our financial condition or results of operations.

### Multiple Deliverable Revenue Arrangements

*(Accounting Standards Updates 2009-13 and 2009-14)*

In October 2009, the FASB issued a new accounting standard which provides guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management's best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. In October 2009, the FASB also issued a new accounting standard which changes revenue recognition for tangible products containing software and hardware elements. Specifically, tangible products containing software and hardware that function together to deliver the tangible products' essential functionality are scoped out of the existing software revenue recognition guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance discussed above. Both standards were effective for us beginning on January 1, 2011. The adoption of this standard did not have a material impact on our consolidated financial statements.

### *Seasonality*

Our operating results and operating cash flows historically have been subject to seasonal variations. Our revenues are usually higher in the second half of the year than in the first half of the year, and the first quarter is usually the slowest quarter because fewer projects are undertaken during and around the Chinese spring festival.

### *Inflation*

We believe our operations have not been materially adversely affected by inflation or changing prices.

### *Off-Balance Sheet Arrangements*

We do not have any off-balance sheet arrangements.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

### *Interest Rate Risk*

We deposit surplus funds with Chinese banks earning daily interest and do not invest in any instruments for trading purposes. Most of our outstanding debt instruments carry fixed rates of interest. Our operations generally are not directly sensitive to fluctuations in interest rates. The amount of long-term debt outstanding as of June 30, 2011 and December 31, 2010 was \$307.08 million and \$73.62 million, respectively. A hypothetical 1.0% increase in the annual interest rates for all of our credit facilities under which we had outstanding borrowings at June 30, 2011, would decrease net income before provision for income taxes by approximately \$1.00 million or 11% for the three months ended June 30, 2011. Management monitors the banks' prime rates in conjunction with our cash requirements to determine the appropriate level of debt balances relative to other sources of funds. We have not entered into any hedging transactions in an effort to reduce our exposure to interest rate risk.

### *Foreign Exchange Risk*

Our reporting currency is the U.S. dollar. Except for the U.S. holding company, all of our consolidated revenues, consolidated costs and expenses, and our assets are denominated in RMB. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be affected by fluctuations in the exchange rate between U.S. dollars and RMB. If the RMB depreciates against the U.S. dollar, the value of our RMB revenues, earnings and

assets as expressed in our U.S. dollar financial statements will decline. Assets and liabilities are translated at exchange rates at the balance sheet dates and revenue and expenses are translated at the average exchange rates and equity is translated at historical exchange rates. Any resulting translation adjustments are not included in determining net income but are included in determining other comprehensive income, a component of equity. An average appreciation (depreciation) of the RMB against the U.S. dollar of 5% would increase our comprehensive income by \$16.67 million based on our outstanding revenues, costs and expenses, assets and liabilities denominated in RMB as of June 30, 2011. As of June 30, 2011, our accumulated other comprehensive income was \$62.29 million. We have not entered into any hedging transactions in an effort to reduce our exposure to foreign exchange risk.

The value of the Renminbi against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions. Since July 2005, the Renminbi has not been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future, PRC authorities may lift restrictions on fluctuations in the Renminbi exchange rate and lessen intervention in the foreign exchange market.

***Inflation***

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenues if the selling prices of our products do not increase with these increased costs.

**ITEM 4. CONTROLS AND PROCEDURES**

*(a) Evaluation of Disclosure Controls and Procedures*

We maintain a system of disclosure controls and procedures. The term disclosure controls and procedures, as defined by regulations of the SEC, means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit to the SEC under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit to the SEC under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Guoshen Tu, our Chief Executive Officer, and Terence Yap, our Chief Financial Officer, have evaluated the design and operating effectiveness of our disclosure controls and procedures as of June 30, 2011. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of June 30, 2011.

*(b) Changes in Internal Controls Over Financial Reporting*

There were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting during the three months ended June 30, 2011.

## PART II

### OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

From time to time, we may have disputes that arise in the ordinary course of our business. Currently, there are no material legal proceedings to which we are a party, or to which any of our property is subject, that we expect to have a material adverse effect on our financial condition, except as follows:

Between March 15, 2011 and April 26, 2011, six purported class action complaints related to the Merger (the Stockholder Actions ) were filed against some or all of the following: the Company, the members of the board of directors of the Company and Merger Sub. On March 15, 2011, the first of the Stockholder Actions was filed in the Court of Chancery of the State of Delaware, captioned Dziak v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6279-CS (the Dziak Complaint ). The plaintiff in the Dziak Complaint alleges, among other things, (1) that members of our board of directors breached their fiduciary duties to the Company's stockholders in connection with the Merger and (2) Mr. Guoshen Tu engaged in acts of self-dealing, unfair dealing, gross overreaching and breaches of his fiduciary duties. The Dziak Complaint seeks, among other things, an order enjoining the defendants from proceeding with the Merger unless and until such time the defendants have acted in accordance with their fiduciary duties to maximize shareholder value, an order directing the defendants to exercise their fiduciary duties to obtain a transaction that is in the best interests of our stockholders, an award of compensatory damages and an award of fees, expenses and costs.

From March 16, 2011 to April 26, 2011, five additional complaints were filed in the Court of Chancery of the State of Delaware, seeking substantially the same relief and making substantially the same allegations as the Dziak Complaint. The additional complaints have the following captions: Levine v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6286-CS (filed March 16, 2011); Smith v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6292-CS (filed March 17, 2011); O Connor v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6296-CS (filed March 18, 2011); Jamal v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6408-CS (filed April 22, 2011); and Musto v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6418-CS (filed April 26, 2011). Certain of the Stockholder Actions additionally allege, among other things, that the Company and Merger Sub have aided and abetted the individual defendants' alleged breaches of fiduciary duties. Certain of the Stockholder Actions additionally seek, among other things, (1) an order enjoining, preliminarily and permanently, the Merger, and (2) an order rescinding the Merger or awarding plaintiff and the class rescissory damages in the event that the Merger is consummated prior to the entry of the court's final judgment.

On May 23, 2011, plaintiffs' counsel in Musto v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6418-CS, filed a motion with the Court of Chancery of the state of Delaware seeking to consolidate five of the pending actions and to have counsel for Mr. Musto appointed as lead plaintiffs' counsel in the consolidated action. On May 27, 2011, the Company, members of the special committee, Terence Yap, and Merger Sub, respectively, filed motions to dismiss the remaining action that was not part of the consolidation motion, Jamal v. China Security & Surveillance Technology, Inc., et al., C.A. No. 6408-CS. On June 7, 2011, four plaintiffs (Levine, Smith, O Connor, and Jamal) filed a joint Amended Complaint containing substantially the same allegations and seeking substantially the same relief as the prior complaints. The joint Amended Complaint was accompanied by a motion for preliminary injunction to block the merger and a motion to expedite discovery. On June 10, 2011, plaintiffs' counsel in the Dziak, Levine, Smith, O Connor, and Jamal actions filed a joint cross-motion to the Musto consolidation motion. The joint cross-motion also sought consolidation of all pending actions, but requested that the law firm of Rigrodsky & Long, P.A. be appointed as lead plaintiffs' counsel in the consolidated action. At a hearing on June 30, 2011, the Court ordered that the six pending cases be consolidated and appointed Rigrodsky & Long, P.A. as the lead plaintiffs' counsel in the consolidated action. A hearing on plaintiffs' motion for a preliminary injunction in the consolidated action is scheduled to occur on August 16, 2011.

On July 21, 2011, a purported class action complaint captioned *Strum v. China Security & Surveillance Technology Inc. et al.*, Case No. 1:11-CV-00646-UNA, was filed in the United States District Court for the District of Delaware. The complaint, which names the same defendants as in the state actions, alleges that the preliminary proxy statement filed on July 8, 2011 is materially false and misleading and that the Merger is unfair to stockholders. It asserts claims under the United States Securities Exchange Act of 1934, as amended, as well as common law claims for breach of fiduciary duty, and seeks a preliminary and permanent injunction prohibiting consummation of the Merger and damages in the event the Merger is consummated.

In September 2010, the Company was notified by the staff of the SEC that it had initiated a SEC Investigation. On or around September 3, 2010 and March 29, 2011, the Company received two separate subpoenas from the SEC requesting the delivery of certain documents to the SEC. The Company is cooperating, and intends to continue to cooperate, with the SEC in connection with such investigation. Receipt of these subpoenas does not mean that the SEC has concluded that the Company or anyone else has violated the law. The investigation does not mean that the SEC has a negative opinion of any person, entity or security. It is not possible to predict the outcome of the investigation, including whether or when any proceedings might be initiated, when these matters may be resolved or what, if any, penalties or other remedies may be imposed.

#### **ITEM 1A. RISK FACTORS**

The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as amended, contains a detailed discussion of certain risk factors that could materially adversely affect our business, our operating results, or our financial condition. The following risk factors related to the proposed Merger supplement, and should be read in conjunction with, that discussion.

***There are risks and uncertainties associated with our proposed Merger with Rightmark Holdings Limited and Merger Sub.***

As previously announced, we have entered into the Merger Agreement providing for the acquisition of the Company by Parent, an entity formed and wholly owned by our CEO and chairman Guoshen Tu . Pursuant to the Merger Agreement, Merger Sub will merge with and into the Company, with the Company surviving the merger as a wholly-owned subsidiary of Parent. There are a number of risks and uncertainties relating to the Merger. For example, the Merger may not be consummated or may not be consummated in the timeframe or manner currently anticipated, as a result of several factors, including, among other things, the failure of one or more of the Merger Agreement's closing conditions, Parent's failure to obtain sufficient financing to complete the Merger, or litigation relating to the Merger. In addition, there can be no assurance that approval of our stockholders will be obtained, that the other conditions to closing of the Merger will be satisfied or waived or that other events will not intervene to delay or result in the termination of the Merger. If the Merger is not completed, the price of our common stock may change to the extent that the current market price of our common stock may reflect an assumption that the Merger will be consummated.

Pending the closing of the Merger, the Merger Agreement also restricts us from engaging in certain actions without Parent's consent, which could prevent us from pursuing opportunities that may arise prior to the closing of the Merger. Any delay in closing or a failure to close could have a negative impact on our business and stock price as well as our relationships with our customers, vendors or employees, as well as a negative impact on our ability to pursue alternative strategic transactions and/or our ability to implement alternative business plans. In addition, if the Merger Agreement is terminated under certain circumstances, we are required to pay a termination fee of up to \$10 million.

***Our business could be adversely impacted as a result of uncertainty related to the Merger.***

The proposed Merger could cause disruptions to our business or business relationships, which could have an adverse impact on our financial condition, results of operations and cash flows. For example:

- the attention of our management may be directed to transaction-related considerations and may be diverted from the day-to-day operations of our business;
- our employees may experience uncertainty about their future roles with us, which might adversely affect our ability to retain and hire key personnel and other employees; and
- customers, suppliers or other parties with which we maintain business relationships may experience uncertainty about our future and seek alternative relationships with third parties or seek to alter their business relationships with us.

In addition, we have incurred, and will continue to incur, significant costs, expenses and fees for professional services and other transaction costs in connection with the Merger, and many of these fees and costs are payable by us regardless of whether or not the Merger is consummated

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. (REMOVED AND RESERVED)**

**ITEM 5. OTHER INFORMATION**

None.



**ITEM 6. EXHIBITS**

**Exhibit**

**Number Description**

- |             |  |
|-------------|--|
| 2.1         | Agreement and Plan of Merger, dated as of April 20, 2011, by and among the Registrant, Rightmark Holdings Limited, Rightmark Merger Sub Limited and Mr. Guoshen Tu (solely for the purpose of Section 6.15) (incorporate by reference to exhibit 2.1 to the current report on Form 8-K filed on April 21, 2011)                |
| 2.2         | Amended and Restated Agreement and Plan of Merger, dated as of May 3, 2011, by and among the Registrant, Rightmark Holdings Limited, Rightmark Merger Sub Limited and Mr. Guoshen Tu (solely for the purpose of Section 6.15) (incorporate by reference to exhibit 2.1 to the current report on Form 8-K filed on May 3, 2011) |
| 10.1        | Limited Guaranty, dated as of April 20, 2011, by Mr. Guoshen Tu in favor of the Registrant (incorporate by reference to exhibit 10.1 to the current report on Form 8-K filed on April 21, 2011).   |
| <u>31.1</u> | <u>Certification of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>   |
| <u>31.2</u> | <u>Certification of Principal Financial Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>   |
| <u>32.1</u> | <u>Certification of Principal Executive Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| <u>32.2</u> | <u>Certification of Principal Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| 101         | Interactive data files pursuant to Rule 405 of Regulation S-T*   |

\* Furnished herewith

**SIGNATURES**

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

DATED: July 25, 2011

**China Security & Surveillance Technology, Inc.**

By: /s/ Guoshen Tu  
Principal Executive Officer

By: /s/ Terence Yap  
Principal Financial Officer

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