

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC.  
Form 10-Q  
April 26, 2010

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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: March 31, 2010

**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 small business issuer 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 [ ]

Accelerated Filer [X]

Non-Accelerated Filer [ ]

Smaller reporting company [ ]

(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 [X]

The number of shares outstanding of each of the issuer's classes of common equity, as of April 22, 2010 is as follows:

| Class of Securities                     | Shares Outstanding |
|---|--------------------|
| <b>Common Stock, \$0.0001 par value</b> | <b>69,063,257</b>  |

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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 MARCH 31, 2010 (UNAUDITED) AND DECEMBER 31, 2009**  
**Expressed in thousands of U.S. dollars**  
**(Except for share and per share amounts)**

**ASSETS**

|   | <b>March 31,<br/>2010</b> | <b>December<br/>31, 2009</b> |
|---|---------------------------|------------------------------|
| Cash and cash equivalents   | \$ 142,293                | \$ 154,483                   |
| Accounts receivable, net  | 300,247                   | 251,604                      |
| Inventories, net  | 73,469                    | 70,141                       |
| Prepayments and deposits  | 4,755                     | 4,706                        |
| Advances to suppliers   | 54,044                    | 39,399                       |
| Other receivables   | 30,326                    | 26,692                       |
| Deferred tax assets - current portion   | 10                        | 13                           |
| Total current assets  | 605,144                   | 547,038                      |
| Deposits paid for acquisition of subsidiaries, properties and intangible assets | 13,726                    | 7,199                        |
| Plant and equipment, net  | 74,856                    | 75,447                       |
| Land use rights, net  | 7,716                     | 7,733                        |
| Intangible assets   | 53,242                    | 54,677                       |
| Goodwill  | 79,511                    | 79,511                       |
| Deferred financing cost   | 1,737                     | 1,953                        |
| <b>TOTAL ASSETS</b>   | <b>\$ 835,932</b>         | <b>\$ 773,558</b>            |

Continued

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**  
**AS OF MARCH 31, 2010 (UNAUDITED) AND DECEMBER 31, 2009**  
**Expressed in thousands of U.S. dollars**  
**(Except for share and per share amounts)**

**LIABILITIES AND EQUITY**

|  | March 31,<br>2010 | December<br>31, 2009 |
|--|-------------------|----------------------|
| <b>CURRENT LIABILITIES</b>   |                   |                      |
| Notes payable  | \$ 134,040        | \$ 57,116            |
| Obligation under product financing arrangements short term   | 5,308             | 5,184                |
| Guaranteed senior unsecured notes payable short term   | 36,127            | 35,701               |
| Accounts and bills payable   | 65,924            | 68,817               |
| Accrued expenses   | 15,836            | 26,762               |
| Advances from customers  | 33,186            | 27,503               |
| Taxes payable  | 16,468            | 14,835               |
| Payable for acquisition of businesses, properties and land use rights  | 5,105             | 5,105                |
| Deferred income  | 2,028             | 1,868                |
| Total current liabilities  | 314,022           | 242,891              |
| <b>LONG TERM LIABILITIES</b>   |                   |                      |
| Obligation under product financing arrangements long term  | 5,168             | 6,541                |
| Guaranteed senior unsecured notes payable long term  | 25,192            | 43,988               |
| Net deferred tax liabilities   | 460               | 773                  |
| Total liabilities  | 344,842           | 294,193              |
| <b>EQUITY</b>  |                   |                      |
| Preferred stock, \$0.0001 par value;<br>10,000,000 shares authorized, 0 shares<br>issued and outstanding   |                   |                      |
| Common stock, \$0.0001 par value;<br>290,000,000 shares authorized<br>68,494,270 (March 31, 2010) and<br>67,866,730 (December 31, 2009) shares<br>issued and outstanding | 7                 | 7                    |
| Additional paid-in capital   | 293,351           | 285,025              |
| Retained earnings  | 169,259           | 165,982              |
| Statutory surplus reserve fund   | 804               | 804                  |
| Accumulated other comprehensive income   | 27,689            | 27,565               |
| Total equity of the Company  | 491,110           | 479,383              |
| Noncontrolling interest  | (20)              | (18)                 |
| Total equity   | 491,090           | 479,365              |
| <b>TOTAL LIABILITIES AND EQUITY</b>  | <b>\$ 835,932</b> | <b>\$ 773,558</b>    |

See the accompanying notes to the condensed consolidated financial statements.



**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 and 2009**

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

|   | Three Months Ended March 31 |             |
|---|-----------------------------|-------------|
|   | 2010                        | 2009        |
|   | (Unaudited)                 | (Unaudited) |
| <b>Revenues</b>   | \$ 120,190                  | \$ 96,416   |
| Cost of goods sold (including depreciation and amortization for the three months ended March 31, 2010 and 2009 of \$254 and \$241, respectively)              | 91,211                      | 71,390      |
| <b>Gross profit</b>   | 28,979                      | 25,026      |
| Selling and marketing   | 2,714                       | 2,714       |
| General and administrative (including non-cash employee compensation for the three months ended March 31, 2010 and 2009 of \$8,326 and \$4,218, respectively) | 16,322                      | 11,507      |
| Depreciation and amortization   | 2,980                       | 2,822       |
| <b>Income from operations</b>   | 6,963                       | 7,983       |
| Interest income   | 78                          | 29          |
| Interest expense  | (2,295)                     | (6,037)     |
| Other income, net   | 246                         | 229         |
| <b>Income before income taxes</b>   | 4,992                       | 2,204       |
| Income taxes  | (1,717)                     | (202)       |
| <b>Net income</b>   | 3,275                       | 2,002       |
| Add: net loss attributable to the noncontrolling interest   | 2                           | 11          |
| <b>Net income attributable to the Company</b>   | 3,277                       | 2,013       |
| Foreign currency translation gain   | 124                         | 54          |
| <b>Comprehensive income attributable to the Company</b>   | 3,401                       | 2,067       |
| Comprehensive loss attributable to the noncontrolling interest  | (2)                         | (11)        |
| <b>Comprehensive income</b>   | \$ 3,399                    | \$ 2,056    |
| <b>NET INCOME PER SHARE</b>   |                             |             |
| <b>ATTRIBUTABLE TO THE COMPANY'S COMMON SHAREHOLDERS</b>  |                             |             |
| BASIC   | \$ 0.05                     | \$ 0.04     |
| DILUTED   | \$ 0.05                     | \$ 0.04     |
| <b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING</b>  |                             |             |
| BASIC   | 63,961,000                  | 45,041,000  |
| DILUTED   | 68,369,000                  | 49,362,000  |

See the accompanying notes to condensed consolidated financial statements





**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 (UNAUDITED)**

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

|  | Common Stock |              | The Company's Shareholders       |                      |   |        | Statutory<br>Surplus<br>Reserve<br>Fund | Noncontrolling<br>Interest | Total<br>Equity |
|--|--------------|--------------|----------------------------------|----------------------|---|--------|---|----------------------------|-----------------|
|  | Shares       | Par<br>Value | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income |        |   |                            |                 |
| <b>BALANCE<br/>AT<br/>JANUARY 1,<br/>2010</b>  | 67,866,730   | \$ 7         | \$ 285,025                       | \$ 165,982           | \$ 27,565                                       | \$ 804 | (18)                                    | \$ 479,365                 |                 |
| Issuance of<br>restricted<br>stock under<br>Equity<br>Incentive Plan<br>and<br>recognition of<br>stock-based<br>compensation | 627,540      | --           | 8,326                            | --                   | --  | --     | --                                      | 8,326                      |                 |
| Foreign<br>currency<br>translation<br>gain   | --           | --           | --                               | --                   | 124   | --     | --                                      | 124                        |                 |
| Net income<br>(loss) for the<br>period   | --           | --           | --                               | 3,277                | --  | --     | (2)                                     | 3,275                      |                 |
| <b>BALANCE<br/>AT MARCH<br/>31, 2010</b>   | 68,494,270   | \$ 7         | \$ 293,351                       | \$ 169,259           | \$ 27,689                                       | \$ 804 | (20)                                    | \$ 491,090                 |                 |

See the accompanying notes to condensed consolidated financial statements

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES CONDENSED  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 and 2009**  
Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)

|   | Three Months Ended March 31 |             |
|---|-----------------------------|-------------|
|   | 2010                        | 2009        |
|   | (Unaudited)                 | (Unaudited) |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                             |             |
| Net income  | \$ 3,275                    | \$ 2,002    |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |                             |             |
| Provision for doubtful accounts   | --                          | 1,396       |
| Depreciation and amortization   | 3,234                       | 3,063       |
| Amortization of consultancy services  | --                          | 11          |
| Amortization of deferred financing cost   | 217                         | 109         |
| Non-cash employee compensation  | 8,326                       | 4,218       |
| Debt discount amortization  | 950                         | --          |
| Redemption accretion on convertible notes   | --                          | 5,375       |
| Deferred taxes  | (310)                       | 31          |
| Changes in operating assets and liabilities:  |                             |             |
| (Increase) decrease in:   |                             |             |
| Accounts receivable   | (48,573)                    | 15,342      |
| Other receivables   | (3,626)                     | 1,739       |
| Inventories   | (3,308)                     | (9,441)     |
| Prepayments and deposits  | (46)                        | 466         |
| Advances to suppliers   | (14,634)                    | (21,315)    |
| (Decrease) increase in:   |                             |             |
| Accounts payable and accrued expenses   | (13,846)                    | (2,222)     |
| Advances from customers   | 5,675                       | 23,195      |
| Taxes payable   | 1,629                       | (2,350)     |
| Deferred income   | 159                         | (184)       |
| Net cash (used in) provided by operating activities   | (60,878)                    | 21,435      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                             |             |
| Additions to plant and equipment  | (597)                       | (393)       |
| Additions to intangible assets  | (533)                       | (804)       |
| Deposits paid for acquisition of subsidiaries   | (6,526)                     | --          |
| Payments for business acquisitions  | --                          | (1,881)     |
| Cash acquired in business acquisitions  | --                          | 273         |
| Net cash used in investing activities   | (7,656)                     | (2,805)     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                             |             |
| New borrowings, net of issuing cost   | 109,137                     | 13,166      |
| Repayment of borrowings   | (32,229)                    | (7,314)     |
| New borrowings from obligation under product financing arrangements                         | --                          | 891         |
| Repayment of obligation under product financing arrangements                                | (1,251)                     | (798)       |
| Repayment of guaranteed senior unsecured notes payable                                      | (19,320)                    | --          |
| Net cash provided by financing activities   | 56,337                      | 5,945       |

|   |            |    |        |
|---|------------|----|--------|
| <b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b> | (12,197)   |    | 24,575 |
| Effect of exchange rate changes on cash                     | 7          |    | 117    |
| Cash and cash equivalents, beginning of period              | 154,483    |    | 47,779 |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>             | \$ 142,293 | \$ | 72,471 |

Continued

**CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES CONDENSED  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 and 2009  
Expressed in thousands of U.S. dollars  
(Except for share and per share amounts)**

| <b>SUPPLEMENTARY CASH FLOW INFORMATION:</b> | <b>Three Months Ended March 31,</b> |                    |
|---|-------------------------------------|--------------------|
|   | <b>2010</b>                         | <b>2009</b>        |
|   | <b>(Unaudited)</b>                  | <b>(Unaudited)</b> |
| Interest paid                               | \$ 1,090                            | \$ 572             |
| Income taxes paid                           | \$ 498                              | \$ 680             |

**SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:**

139,573 shares of common stock were issued in satisfaction of a payable of approximately \$906 related to the acquisition of DIT Industry (H.K.) Limited ( DIT ) in February 2009.

341,228 shares of common stock were issued in satisfaction of the purchase price of approximately \$1,669 in the acquisition of Shenzhen Coson Electronic Co. Ltd. ( Coson ) in February 2009. Additionally, the Company recorded a liability in the amount of \$1,170 representing the estimated fair value of contingent consideration, to be payable in cash, issued in the acquisition.

See the 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**

The accompanying financial statements, as of March 31, 2010 and for the three months ended March 31, 2010 and 2009, 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, 2009, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the SEC on March 2, 2010, as amended on March 10, 2010. Amounts as of December 31, 2009 are derived from these audited consolidated financial statements.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

In the opinion of the management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position as of March 31, 2010, results of operations and cash flows for the three months ended March 31, 2010 and 2009, have been made. The results of operations for the three months ended March 31, 2010 are not necessarily indicative of the operating results for the full year.

**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**

Accounting Standards Codification (ASC) 820 *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. It also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and that market participant assumptions include assumptions about risk and effect of a restriction on the sale or use of an asset.

This ASC establishes 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 March 31, 2010, the Company has no financial assets or liabilities subject to recurring fair value measurements.

**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)**

**(b) Fair Value - continued**

ASC 825-10 *Financial Instruments* allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option), may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, unrealized gains and losses for that instrument should be reported in earning at each subsequent reporting date. The Company has not elected to apply the fair value option to any outstanding instruments.

The Company's financial instruments include cash and cash equivalents, accounts receivable, other receivables, accounts and bills payable, notes payable, obligation 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.

**(c) Accounts Receivable**

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

No trade receivable due from any single individual customer exceeds 10% of total accounts receivable at March 31, 2010 and December 31, 2009.

From time to time, the Company enters into receivable factoring agreements. The Company accounts for those arrangements under ASC 860 *Transfer 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.

**(d) Inventories**

Inventories 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 year 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 year the impairment or loss occurs. There were no declines in net realizable value of inventory for the three months ended March 31, 2010 and 2009.

As of March 31, 2010 and December 31, 2009, inventories held under the product financing arrangements were \$12,957 and \$12,953, respectively.

During the three months ended March 31, 2010 and 2009, inventory purchases from the top five suppliers constituted approximately 46% and 28% of the total inventory purchases, respectively.

**(e) 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 5 years. The Company performs periodic reviews to ensure that unamortized program costs remain recoverable from future revenue.

As of March 31, 2010 and December 31, 2009, unamortized computer software costs were \$4,984 and \$4,693, respectively. During the three months ended March 31, 2010 and 2009, \$313 and \$316 amortization expense was charged to income, respectively.



**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)**

**(f) 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 title to the product is transferred, which generally take place when products are shipped to or accepted by the customer, depending on the terms of the contract;
- (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.

The 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. As of March 31, 2010 and December 31, 2009, no material product warranty reserve was accrued. Warranty costs incurred by the Company have not been material.

The Company derives the bulk of its 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*. Revenue from the supply and installation of surveillance and safety equipment are recognized when the installation is completed and the customer acceptance is received. Approximately 1% of contract installation revenue is deferred for the repair work during the one year warranty period. The Company carefully monitors the warranty work requested by its customers, and has determined that very little warranty work has historically been requested to be performed. Management believes that this 1% warranty reserve appears adequate as of March 31, 2010 and December 31, 2009.

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 postcontract 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 the Company believes it meets the conditions in compliance with the ASC guidance.

**(g) 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 months ended March 31, 2010 and 2009 amounted to \$633 and \$670, respectively.

**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) Advertising Costs**

The Company expenses advertising costs as incurred or the first time advertising takes place. During the three months ended March 31, 2010 and 2009, the Company incurred advertising costs of approximately \$649 and \$97, respectively.

**(i) 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. The retirement benefit expenses for the three months ended March 31, 2010 and 2009 were \$290 and \$270, respectively and are included in the selling and marketing expenses and general and administrative expenses.

**(j) 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 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 was not subject to U.S. federal tax examinations for years before 2006. 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's effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses, temporary differences, and preferential tax treatment.

**(k) 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.

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

**(k) Earnings Per Share continued**

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, 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.

The calculation of diluted earnings per share is based on the outstanding warrants for the three months ended March 31, 2010 and 2009. As of March 31, 2010, warrants were outstanding to acquire 3,528,302 shares of common stock. Warrants which were outstanding to acquire 3,498,296 and 174,515 shares of common stock, respectively, were not included in the dilutive calculation for the three months ended March 31, 2010 and 2009, as the effect would be anti-dilutive.

Basic and diluted earnings per share for the three months ended March 31, 2010 and 2009 were calculated as follows:

|  | <b>2010</b> | <b>2009</b> |
|--|-------------|-------------|
| Net income attributable to the Company         | \$ 3,277    | \$ 2,013    |
| Weighted average number of common shares:      |             |             |
| Basic  | 63,961,000  | 45,041,000  |
| Effect of diluted securities:                  |             |             |
| Warrants                                       | 11,000      | --          |
| Employee share-based compensation              | 4,397,000   | 4,321,000   |
| Diluted  | 68,369,000  | 49,362,000  |
| Earnings per share attributable to the Company |             |             |
| Basic  | \$ 0.05     | \$ 0.04     |
| Diluted  | \$ 0.05     | \$ 0.04     |

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

**(I) New Accounting Standards**

**Accounting for Transfers of Financial Assets**

*(Included in ASC 860 Transfers and Servicing )*

This ASC guidance addresses information a reporting entity provides in its financial statements about the transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. Also, this ASC guidance removes the concept of a qualifying special purpose entity, limits the circumstances in which a transferor derecognizes a portion or component of a financial asset, defines participating interest and enhances the information provided to financial statement users to provide greater transparency. This guidance was effective for the Company as of January 1, 2010. The adoption of this guidance had no impact on the Company's consolidated financial statements.

**Consolidation of Variable Interest Entities Amended**

*(Included in ASC 810 Consolidation )*

Revisions under ASC 810 require an enterprise to perform an analysis to determine the primary beneficiary of a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity. This ASC guidance also requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity. ASC 810 was effective for the Company as of January 1, 2010. The adoption of this guidance had no impact on the Company's consolidated financial statements.

**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 will be effective for the Company in the first quarter of 2011. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of this standard may have on its consolidated financial statements.

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**3. ACCOUNTS RECEIVABLE**

The Company provides an allowance for doubtful accounts related to its receivables. The receivables and allowance balances at March 31, 2010 and December 31, 2009 are as follows:

|                                       | <b>March 31,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|---------------------------------------|---------------------------|----------------------------------|
| Accounts receivable                   | \$ 302,252                | \$ 253,610                       |
| Less: allowance for doubtful accounts | (2,005)                   | (2,006)                          |
| Accounts receivable, net              | \$ 300,247                | \$ 251,604                       |

**4. INVENTORIES**

Inventories consist of the following as of March 31, 2010 and December 31, 2009:

|  | <b>March 31,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|--|---------------------------|----------------------------------|
| Raw materials                            | \$ 16,273                 | \$ 14,292                        |
| Work in progress                         | 2,114                     | 2,212                            |
| Finished goods                           | 25,986                    | 18,790                           |
| Installations in process                 | 30,620                    | 36,371                           |
| Total                                    | 74,993                    | 71,665                           |
| Less: allowance for obsolete inventories | (1,524)                   | (1,524)                          |
| Inventories, net                         | \$ 73,469                 | \$ 70,141                        |

**5. PREPAYMENTS AND DEPOSITS**

Prepayments and deposits consist of the following as of March 31, 2010 and December 31, 2009:

|   | <b>March 31,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|---|---------------------------|----------------------------------|
| Current portion   | \$ 4,755                  | \$ 4,706                         |
| Non current portion   |                           |                                  |
| - Deposits paid for acquisition of subsidiaries                     | 11,608                    | 5,081                            |
| - Deposits paid for acquisition of properties and intangible assets | 2,118                     | 2,118                            |
|   | \$ 13,726                 | \$ 7,199                         |

The deposits paid for acquisition of subsidiaries, properties and intangible assets are refundable. There are no commitments to acquire the subsidiaries, properties and intangible assets.

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**6. ADVANCE PAYMENTS**

The Company has made payments to unrelated suppliers in advance of receiving merchandise. The advance payments are meant to ensure preferential pricing and delivery. The amounts advanced under such arrangements totaled \$54,044 and \$39,399 as of March 31, 2010 and December 31, 2009, respectively.

**7. PLANT AND EQUIPMENT**

At March 31, 2010 and December 31, 2009, plant and equipment, at cost, consist of:

|                                | <b>March 31,</b> | <b>December</b> |
|--------------------------------|------------------|-----------------|
|                                | <b>2010</b>      | <b>31,</b>      |
|                                |                  | <b>2009</b>     |
| Buildings                      | \$ 62,120        | \$ 62,102       |
| Leasehold improvements         | 2,983            | 2,763           |
| Plant and equipment            | 8,099            | 7,971           |
| Electronic equipment           | 9,473            | 9,305           |
| Motor vehicles                 | 5,344            | 5,343           |
|                                | 88,019           | 87,484          |
| Less: accumulated depreciation | (13,163)         | (12,037)        |
| Plant and equipment, net       | \$ 74,856        | \$ 75,447       |

Depreciation expense for the three months ended March 31, 2010 and 2009 was \$1,209 and \$1,023, respectively.

**8. LAND USE RIGHTS**

Land use rights consist of the following as of March 31, 2010 and December 31, 2009:

|                                | <b>March 31,</b> | <b>December</b> |
|--------------------------------|------------------|-----------------|
|                                | <b>2010</b>      | <b>31,</b>      |
|                                |                  | <b>2009</b>     |
| Cost of land use rights        | \$ 8,529         | \$ 8,526        |
| Less: accumulated amortization | (813)            | (793)           |
| Land use rights, net           | \$ 7,716         | \$ 7,733        |

Amortization expense for the three months ended March 31, 2010 and 2009 was \$42 and \$43, respectively.

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

|                                   |          |
|-----------------------------------|----------|
| 2010 (for the remaining 9 months) | \$ 128   |
| 2011                              | 171      |
| 2012                              | 171      |
| 2013                              | 171      |
| 2014                              | 171      |
| 2015                              | 171      |
| Thereafter                        | 6,733    |
| Total                             | \$ 7,716 |





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**9. INTANGIBLE ASSETS**

|   | March 31,<br>2010 | December<br>31,<br>2009 |
|---|-------------------|-------------------------|
| 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)          | 17,030            | 17,030                  |
| 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)             | 9,812             | 9,268                   |
| Surveillance recording system (life of 5 years)     | 500               | 500                     |
|   | 74,899            | 74,355                  |
| Less: accumulated amortization                      | (21,657)          | (19,678)                |
| Intangible assets, net                              | \$ 53,242         | \$ 54,677               |

The amortization expense for the three months ended March 31, 2010 and 2009 was \$1,983 and \$1,997, respectively.

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

|                                      |           |
|--------------------------------------|-----------|
| 2010 (for the remaining nine months) | \$ 5,983  |
| 2011                                 | 6,578     |
| 2012                                 | 5,787     |
| 2013                                 | 5,294     |
| 2014                                 | 4,758     |
| 2015                                 | 3,877     |
| Thereafter                           | 20,965    |
| Total                                | \$ 53,242 |

**10. NOTES PAYABLE**

The Company's notes payable to banks (all current) as of March 31, 2010 and December 31, 2009 are \$134,040 and \$57,116, respectively.

Repayments under the terms of the notes are as follows:

|                                      | Short-term<br>notes |
|--------------------------------------|---------------------|
| 2010 (for the remaining nine months) | \$ 35,890           |
| 2011                                 | 98,150              |
| Total                                | \$ 134,040          |

On March 31, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB50,000 (approximately \$7,325) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by the CEO of the Company, his wife, and a subsidiary of the Company, and is 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 \$13,184) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by the CEO of the Company, his wife and a subsidiary of the Company, and 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 \$8,790) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by the CEO of the Company, his wife and a subsidiary of the Company, and properties of two subsidiaries of the Company.

On March 4, 2010, the Company entered into a loan agreement with Industrial and Commercial Bank of China. The Company borrowed RMB31,000 (approximately \$4,541) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by three subsidiaries of the Company, and is collateralized by property of a subsidiary.

On March 4, 2010, the Company entered into a loan agreement with Industrial and Commercial Bank of China. The Company borrowed RMB39,000 (approximately \$5,713) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by three subsidiaries of the Company, and is collateralized by property of a subsidiary.

On March 3, 2010, the Company entered into a loan agreement with China Construction Bank. The Company borrowed RMB50,000 (approximately \$7,325) with an annual interest rate equal to 5.58%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by the CEO of the Company and a subsidiary of the Company, and is collateralized by property of a subsidiary of the Company.

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**10. NOTES PAYABLE (CONTINUED)**

On March 2, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB41,000 (approximately \$6,006) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by the CEO of the Company, his wife, and a subsidiary of the Company, and is collateralized by the property and land use rights of a subsidiary.

On February 26, 2010, the Company entered into a loan agreement with Bank of China. The Company borrowed RMB48,000 (approximately \$7,031) with an annual interest rate equal to 5.04%, with interest payable on the 20th of each month. The loan is due in November 2010. The loan is guaranteed by the CEO of the Company and two subsidiaries of the Company, collateralized by the property and land use rights of a subsidiary.

On February 11, 2010, the Company entered into a loan agreement with Bank of China. The Company borrowed RMB75,000 (approximately \$10,987) with an annual interest rate equal to 5.84%, with interest payable on the 20th of each month. The loan is due in February 2011. The loan is guaranteed by the CEO of the Company and two subsidiaries of the Company, collateralized by the property and land use rights of a subsidiary.

On February 8, 2010, the Company entered into a loan agreement with Societe Generale. The Company borrowed RMB27,000 (approximately \$3,955) with an annual interest rate equal to 4.86%, with interest payable on the due date of the loan. The loan is due in August 2010. The loan is guaranteed by a subsidiary of the Company.

On February 3, 2010, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB59,000 (approximately \$8,643) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in February 2011. The loan is guaranteed by the CEO of the Company, his wife, and a subsidiary of the Company, and is collateralized by the property and land use rights of a subsidiary.

On January 26, 2010, the Company entered into a loan agreement with Industrial and Commercial Bank of China. The Company borrowed RMB100,000 (approximately \$14,649) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan is due in January 2011. The loan is guaranteed by the CEO of the Company.

On January 7, 2010, the Company entered into a loan agreement with Bank of China. The Company borrowed RMB75,000 (approximately \$10,987) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in January 2011. The loan is guaranteed by the CEO of the Company and two subsidiaries of the Company, collateralized by the property and land use rights of a subsidiary.

On December 25, 2009, the Company entered into a loan agreement with Bank of Ningbo. The Company borrowed RMB30,000 (approximately \$4,395) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in December 2010. The loan is guaranteed by the CEO of the Company and a subsidiary of the Company.

On December 11, 2009, the Company entered into a loan agreement with Agricultural Bank of China. The Company borrowed RMB20,000 (approximately \$2,930) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan was due in September 2010. The loan was guaranteed by the CEO and COO of the Company and a subsidiary of the Company, and was collateralized by the land use right and properties of a subsidiary. The loan was repaid in January 2010.

On December 11, 2009, the Company entered into a loan agreement with Agricultural Bank of China. The Company borrowed RMB20,000 (approximately \$2,930) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan was due in October 2010. The loan was guaranteed by the CEO and COO of the Company and a subsidiary of the Company, and was collateralized by the land use right and properties of a subsidiary. The loan was repaid in January 2010.

On November 6, 2009, the Company entered into a loan agreement with Industrial and Commercial Bank of China. The Company borrowed RMB50,000 (approximately \$7,325) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in November 2010. The loan is guaranteed by three subsidiaries of the Company, and is collateralized by the land use rights and property of a subsidiary.

On September 30, 2009, the Company entered into a loan agreement with Shenzhen Development Bank. The Company borrowed RMB20,000 (approximately \$2,930) with an annual interest rate equal to 105% of benchmark lending rate (5.5755% as of March 31, 2010), with interest payable on the 20th of each month. The loan is due in September 2010. The loan is guaranteed by the CEO of the Company and two subsidiaries of the Company, and is collateralized by the property of a subsidiary.

On August 13, 2009, the Company entered into a loan agreement with China Construction Bank. The Company borrowed RMB30,000 (approximately \$4,395) with an annual interest rate equal to 5.5755%, with interest payable on the 20th of each month. The loan is due in August 2010. The loan is collateralized by the property of a subsidiary.

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**10. NOTES PAYABLE (CONTINUED)**

On May 20, 2009, the Company entered into a loan agreement with China Everbright Bank Co., Ltd. The Company borrowed RMB40,000 (approximately \$5,859) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in May 2010. The loan is guaranteed by the CEO of the Company, a subsidiary of the Company, and Chuang Guan.

On April 15, 2009, the Company entered into a loan agreement with Shanghai PuDong Development Bank. The Company borrowed RMB80,000 (approximately \$11,716) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan was due in April 2010 and repaid in March 2010. The loan was collateralized by the properties of two subsidiaries.

On April 1, 2009, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB50,000 (approximately \$7,325) with an annual interest rate equal to 92% of benchmark lending rate (4.89% as of March 31, 2010), with interest payable on the 20th of each month. The loan was due in April 2010 and repaid in March 2010. The loan was guaranteed by the CEO of the Company, his wife, and subsidiaries of the Company, and was collateralized by the land use rights of a subsidiary.

On February 25, 2009, the Company entered into a loan agreement with China Merchants Bank. The Company borrowed RMB60,000 (approximately \$8,789) with an annual interest rate equal to 92% of benchmark lending rate (4.89% as of March 31, 2010). The loan was due in February 2010 and the interest was payable on the 20th of each month. The loan was guaranteed by the CEO of the Company, his wife and subsidiaries of the Company, and was collateralized by the land use rights of a subsidiary. The Company repaid RMB 10,000 (approximately \$1,464) and RMB50,000 (approximately \$7,325) in March 2009 and in the first quarter of 2010, respectively.

**11. OBLIGATIONS UNDER PRODUCT FINANCING ARRANGEMENTS**

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 \$7,322). The loans expire in September 2012, and payments 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 \$1,041). The loans expire in February 2013, and payments 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 \$7,845). The loans expire in July 2011, and payments are due at the end of each quarter.

The Company paid \$271 and \$188, respectively, during the three months ended March 31, 2010 and 2009 of interest expense on the product financing arrangements.



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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 March 31, 2010 and December 31, 2009:

|   | <b>March 31,</b> | <b>December</b> |
|---|------------------|-----------------|
|   | <b>2010</b>      | <b>31,</b>      |
|   |                  | <b>2009</b>     |
| Obligation under product financing arrangements | \$ 10,476        | \$ 11,725       |
| Less: current portion                           | (5,308)          | (5,184)         |
| Long-term portion                               | \$ 5,168         | \$ 6,541        |

Estimated repayments are as follows:

|                                      |           |
|--------------------------------------|-----------|
| 2010 (for the remaining nine months) | \$ 4,566  |
| 2011                                 | 4,554     |
| 2012                                 | 2,323     |
| 2013                                 | 174       |
| Total                                | 11,617    |
| Less: amount representing interest   | (1,141)   |
| Net                                  | \$ 10,476 |

Approximately RMB10,206 (approximately \$1,495) and RMB11,373 (approximately \$1,665) of other costs directly associated with the product financing agreements is recorded as deferred financing costs in the balance sheet at March 31, 2010 and December 31, 2009, respectively. The Company is amortizing these financing costs over the term of the obligation. The amortization is recorded as interest expense, which was \$192 and \$100, respectively for the three months ended March 31, 2010 and 2009.

**12. DEFERRED INCOME**

Deferred income balances as of March 31, 2010 and December 31, 2009, were \$2,028 and \$1,868 respectively, and represented amounts invoiced but deferred as revenue as an estimated warranty reserve.

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**13. GUARANTEED SENIOR UNSECURED NOTES PAYABLE**

As of March 31, 2010, the Company has outstanding Tranche B Zero Coupon Guaranteed Senior Unsecured Notes (the Tranche B Notes ). The Tranche B Notes had a 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, starting 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 principal on the Tranche B Notes in March 2010.

The Company has recorded \$950 of debt discount amortization for the three months ended March 31, 2010 related to the Tranche B Notes. This amount is included in interest expense.



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

Approximately \$300 of legal fees and other costs directly associated with the issuance of the Tranche B Notes is recorded as deferred financing costs in the balance sheet at March 31, 2010. The Company is amortizing these financing costs over the life of the Tranche B Notes. The amortization for the three months ended March 31, 2010 was \$25.

The following is a summary of the guaranteed senior unsecured notes payable as of March 31, 2010 and December 31, 2009:

|                       | <b>March 31,</b> | <b>December</b> |
|-----------------------|------------------|-----------------|
|                       | <b>2010</b>      | <b>31,</b>      |
|                       |                  | <b>2009</b>     |
| Total                 | \$ 61,319        | \$ 79,689       |
| Less: current portion | (36,127)         | (35,701)        |
| Long-term portion     | \$ 25,192        | \$ 43,988       |

Repayments under the terms of the notes are as follows:

|  |           |
|--|-----------|
| 2010 (remaining nine months)                   | \$ 19,320 |
| 2011   | 38,640    |
| 2012   | 6,720     |
| Total  | 64,680    |
| Less: amount representing unamortized discount | (3,361)   |
| Net  | \$ 61,319 |

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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)

**14. WARRANTS**

A summary of the status of the Company's warrants issued in 2009, 2008 and 2006, and the changes during the three months ended March 31, 2010 and 2009, is presented below:

|                                  | 2010      |                          | 2009    |                          |
|----------------------------------|-----------|--------------------------|---------|--------------------------|
|                                  | Shares    | Weighted Exercise Prices | Shares  | Weighted Exercise Prices |
| Outstanding at January 1         | 3,528,302 | \$ 8.72                  | 174,515 | \$ 16.75                 |
| Granted                          | --        | --                       | --      | --                       |
| Exercised                        | --        | --                       | --      | --                       |
| Outstanding at March 31          | 3,528,302 | \$ 8.72                  | 174,515 | \$ 16.75                 |
| Warrants exercisable at March 31 | 3,528,302 | \$ 8.72                  | 174,515 | \$ 16.75                 |

**15. EQUITY INCENTIVE PLAN**

On February 7, 2007, the Company adopted the 2007 Equity Incentive Plan (the "Plan"), which was amended in February 2010. 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.

During the three months ended March 31, 2010 and 2009, 686,705 and 419,818 shares of restricted stock were granted. During the three months ended March 31, 2010 and 2009, 59,165 and 0 shares of restricted stock were forfeited and retired, respectively. The shares that have been issued under the Plan vest over a four to five-year period, and at issuance, resulted in total deferred compensation of \$84,624 and \$80,101 as of March 31, 2010 and December 31, 2009, respectively. The fair values of these restricted stock awards are equal to the fair value of the Company's stock on the date of grant, after taking into account certain discount. Such restricted stock is subject to the risk of forfeiture upon the occurrence of certain events. During the three months ended March 31, 2010 and 2009, the Company recognized \$8,326 and \$4,218, respectively, of compensation expense under the plan. As of March 31, 2010 and December 31, 2009, there was \$40,799 and \$44,632 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 months ended March 31, 2010 and 2009, 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 March 31, 2010 and 2009:

| Nonvested Restricted Stock<br>and<br>Stock Unit Awards<br>2010 |   | Nonvested Restricted Stock<br>and<br>Stock Unit Awards<br>2009 |   |
|--|---|--|---|
| Number of<br>Shares  | Weighted<br>Average<br>Grant<br>Date Fair<br>Values | Number of<br>Shares  | Weighted<br>Average<br>Grant<br>Date Fair<br>Values |
|  |   |  |   |

|                          |           |    |         |           |    |         |
|--------------------------|-----------|----|---------|-----------|----|---------|
| Outstanding at January 1 | 4,713,983 | \$ | 9.47    | 4,415,292 | \$ | 11.92   |
| Granted                  | 686,705   |    | 7.78    | 419,818   |    | 4.35    |
| Vested                   | (857,055) |    | (9.71)  | (343,573) |    | (12.26) |
| Forfeited                | (59,165)  |    | (13.79) | --        |    | --      |
| Outstanding at March 31  | 4,484,468 | \$ | 9.11    | 4,491,537 | \$ | 11.32   |

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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. 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 three 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 ); and
- (c) Distribution of surveillance and safety products: sells surveillance and safety products, including intrusion security, access control and video management systems (the Distribution 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 months ended March 31, 2010 and 2009:

Revenues by segment for the three months ended March 31, 2010 and 2009 are as follows:

| <b>Revenues<sup>(1)</sup></b> | <b>2010</b> | <b>2009</b> |
|-------------------------------|-------------|-------------|
| Installation Segment          | \$ 92,749   | \$ 74,920   |
| Manufacturing Segment         | 16,009      | 15,310      |
| Distribution Segment          | 11,432      | 6,186       |
|                               | \$ 120,190  | \$ 96,416   |

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

Income (loss) by segment for the three months ended March 31, 2010 and 2009 are as follows:

| <b>Income from operations</b>       | <b>2010</b>     | <b>2009</b>     |
|-------------------------------------|-----------------|-----------------|
| Installation Segment                | \$ 19,742       | \$ 13,998       |
| Manufacturing Segment               | (1,051)         | (458)           |
| Distribution Segment                | (661)           | (376)           |
| Corporate and others <sup>(1)</sup> | (11,067)        | (5,181)         |
| <b>Income from operations</b>       | <b>6,963</b>    | <b>7,983</b>    |
| Corporate interest income           | 78              | 29              |
| Corporate interest expense          | (2,295)         | (6,037)         |
| Corporate other income              | 246             | 229             |
| <b>Income before income taxes</b>   | <b>4,992</b>    | <b>2,204</b>    |
| Income taxes                        | (1,717)         | (202)           |
| <b>Net income</b>                   | <b>\$ 3,275</b> | <b>\$ 2,002</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 March 31, 2010 and 2009 is as follows:

| <b>Non-cash employee compensation</b> | <b>2010</b> | <b>2009</b> |
|---------------------------------------|-------------|-------------|
| Installation Segment                  | \$ 566      | \$ 508      |
| Manufacturing Segment                 | 936         | 735         |
| Distribution Segment                  | 362         | 352         |
| Corporate and others                  | 6,462       | 2,623       |
|                                       | \$ 8,326    | \$ 4,218    |

**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. CONSOLIDATED SEGMENT DATA (CONTINUED)**

Total assets by segment as of March 31, 2010 and December 31, 2009 are as follows:

| <b>Total assets</b>                 | <b>March 31,</b> | <b>December</b> |
|-------------------------------------|------------------|-----------------|
|                                     | <b>2010</b>      | <b>31,</b>      |
|                                     |                  | <b>2009</b>     |
| Installation Segment                | \$ 510,463       | \$ 476,743      |
| Manufacturing Segment               | 181,482          | 188,978         |
| Distribution Segment                | 47,290           | 47,458          |
| Corporate and others <sup>(1)</sup> | 96,697           | 60,379          |
|                                     | \$ 835,932       | \$ 773,558      |

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

Goodwill by segment as of March 31, 2010 and December 31, 2009, is as follows:

| <b>Goodwill</b>       | <b>March 31,</b> | <b>December</b> |
|-----------------------|------------------|-----------------|
|                       | <b>2010</b>      | <b>31,</b>      |
|                       |                  | <b>2009</b>     |
| Installation Segment  | \$ 11,079        | 11,079          |
| Manufacturing Segment | 56,456           | 56,456          |
| Distribution Segment  | 11,976           | 11,976          |
|                       | \$ 79,511        | 79,511          |

Depreciation and amortization by segment for the three months ended March 31, 2010 and 2009 are as follows:

| <b>Depreciation and amortization</b> | <b>2010</b> | <b>2009</b> |
|--------------------------------------|-------------|-------------|
| Installation Segment                 | \$ 1,091    | \$ 1,137    |
| Manufacturing Segment                | 1,586       | 1,453       |
| Distribution Segment                 | 352         | 357         |
| Corporate and others                 | 205         | 116         |
|                                      | \$ 3,234    | \$ 3,063    |

## 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 of the Company 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, 2009 and the subsequent SEC filings.

All statements other than statements of historical fact are statements that could be deemed forward-looking statements. The Company assumes no obligation and does not intend to update these forward-looking statements, except as required by law.

### *Use of terms*

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

- Allied Rich refer to Allied Rich Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Chain Star refer to Chain Star Investments Limited, a Hong Kong corporation and an indirect, wholly owned subsidiary of the Company;
- Cheng Feng refer 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 refer 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;
- CSSM are to 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;
- 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 (HK) 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;
- RMB are to Yuan Renminbi of China;
- U.S. dollar, \$ and US\$ are to United States dollars;
- 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 are primarily engaged, through our indirect Chinese subsidiaries, in the manufacturing, distributing, installing, and servicing of surveillance and safety products and systems and developing surveillance and safety related software in China. Our customers are primarily comprised of: (1) governmental entities, such as 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, banks, mines, railways, supermarkets, and entertainment venues.

A majority of our revenues are derived from the provision of surveillance and safety packaged solutions, including manufacturing, installation and after-sale service maintenance of surveillance and safety systems. Because the majority of our revenues are derived from installations, they are generally non-recurring. Our revenues are not concentrated within any one customer or group of related customers. Maintenance services in our packaged solutions are included for the first year following installation. Our customers may separately purchase maintenance services after the first year.

Our sales network covers most of China's populated areas, and we do not rely on any particular region for revenues. Our subsidiaries collectively have more than 140 branch offices and distribution points.

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

Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions and assesses operating performance. We report financial and operating information in the following three segments:

- The Installation Segment provides design, sales, installation, services and monitoring of electronics surveillance and safety systems to residential, commercial, industrial and governmental customers (the Installation Segment );
- The Manufacturing Segment provides design, manufacturing and sales of surveillance and safety products, including intrusion security, access control and video management systems (the Manufacturing Segment ); and
- The Distribution Segment provides distribution and sales of surveillance and safety products and services, including intrusion security, access control and video management systems (the Distribution Segment ).

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

### ***First Quarter Financial Performance Highlights***

We continued to experience strong demand for our products and services during the first quarter of 2010 and growth in our revenues. The surveillance and safety product market in China continued to expand in the first quarter of 2010 due, in part, to several programs and regulatory drivers initiated by the Chinese government, such as State Ordinance 458 and the Safe City program, which require many public places to install security systems, including city-wide surveillance systems, traffic conjunctions, critical government locations, cyber cafés, bars and discotheques. The ongoing installation of these security systems as required by applicable Chinese law is being conducted by the affected constituents. In addition, economic development in China and the general rise in affluence of the population of China continue to contribute to increased demand for surveillance and safety products within various industries and organizations, such as residential real estate, factories and shopping centers. Our first quarter financial results also included the consolidation of Coson acquired in January 2009, which contributed approximately \$0.82 million in revenue, accounting for approximately 0.7% of the total revenues for the first quarter of 2010.



Following are some financial highlights for the first quarter of 2010:

- *Revenues*: Revenues increased \$23.77 million, or 24.7%, to \$120.19 million for the three months ended March 31, 2010, from \$96.42 million for the three months ended March 31, 2009.
- *Gross margin*: Gross margin was 24.1% for the three months ended March 31, 2010, compared to 26.0% for the three months ended March 31, 2009. Such decrease was primarily due to a change of product mix and lower sales prices.
- *Income from operations*: Income from operations decreased \$1.01 million, or 12.7%, to \$6.97 million for the three months ended March 31, 2010, from \$7.98 million in 2009.
- *Operating margin*: Operating margin (the ratio of income from operations to revenues, expressed as a percentage) was 5.8% for the three months ended March 31, 2010, compared to 8.3% in 2009.
- *Net income*: Net income increased \$1.28 million, or 64.0%, to \$3.28 million for the three months ended March 31, 2010, from \$2.00 million for the three months ended March 31, 2009.
- *Net margin*: Net margin (the ratio of net income to revenues, expressed as a percentage) was 2.8% for the three months ended March 31, 2010, compared to 2.1% for the three months ended March 31, 2009. The increase was primarily due to non-cash expenses described below.
- *Fully diluted net income per share*: Fully diluted net income per share was \$0.05 for the three months ended March 31, 2010, as compared to \$0.04 for the three months ended March 31, 2009.
- *Non-cash expenses*: Total non-cash expenses were \$11.56 million for the three months ended March 31, 2010, representing a decrease of \$1.10 million, or 8.7%, from \$12.66 million during the same period last year. Non-cash expenses for the three months ended March 31, 2010 included (i) depreciation and amortization of \$3.23 million, and (ii) non-cash employee compensation expense of \$8.33 million.

Our net income for the periods ended March 31, 2010 and 2009 was approximately \$3.28 million and \$2.00 million, respectively. Our net income was materially impacted by: depreciation and amortization of long-lived assets in the subsidiaries we acquired; non-cash employee compensation recognized pursuant to Accounting Standard Codification ( ASC ) 718; redemption accretion on convertible notes we issued in February and April 2007. In the table below, we have presented a non-GAAP financial disclosure to provide a quantitative analysis of the impact of the depreciation and amortization of long-lived assets in the subsidiaries we acquired, non-cash employee compensation and redemption accretion on convertible notes on our net income. Because these items do not require the use of current assets, management does not include these items in its analysis of our financial results or how we allocate our resources. Because of this, we deemed it meaningful to provide this non-GAAP disclosure of the impact of these significant items on our financial results.

The following table summarizes the Company's non-cash expenses during the three months ended March 31, 2010 and 2009.

| All amounts in millions of U.S. dollars                        |      |       |      |       |                          |
|--|------|-------|------|-------|--------------------------|
| Non-cash expenses  | 2010 |       | 2009 |       | Increase /<br>(Decrease) |
| Depreciation and amortization                                  | \$   | 2.98  | \$   | 2.82  | \$ 0.16                  |
| Depreciation and amortization (included in cost of goods sold) |      | 0.25  |      | 0.24  | 0.01                     |
| Non-cash employee compensation                                 |      | 8.33  |      | 4.22  | 4.11                     |
| Redemption accretion on convertible notes                      |      | --    |      | 5.38  | (5.38)                   |
| <b>Total</b>   | \$   | 11.56 | \$   | 12.66 | \$ (1.10)                |

### *Results of Operations*

The following table sets forth key components of our results of operations for the three months ended March 31, 2010 and 2009, in dollars and as a percentage of revenues.

| All amounts, other than percentages, in millions of U.S. dollars                                      |      |         |        |      |         |        |
|---|------|---------|--------|------|---------|--------|
|   | 2010 |         |        | 2009 |         |        |
| <b>Revenues</b>   | \$   | 120.19  | 100.0% | \$   | 96.42   | 100.0% |
| Cost of goods sold (including depreciation and amortization amounted \$0.25 and \$0.24, respectively) |      | (91.21) | 75.9%  |      | (71.39) | 74.0%  |
| <b>Gross profit</b>   |      | 28.98   | 24.1%  |      | 25.03   | 26.0%  |
| Selling and marketing   |      | (2.71)  | 2.3%   |      | (2.71)  | 2.8%   |
| General and administrative  |      | (7.99)  | 6.6%   |      | (7.30)  | 7.6%   |
| Non-cash employee compensation  |      | (8.33)  | 6.9%   |      | (4.22)  | 4.4%   |
| Depreciation and amortization   |      | (2.98)  | 2.5%   |      | (2.82)  | 2.9%   |
| <b>Income from operations</b>   |      | 6.97    | 5.8%   |      | 7.98    | 8.3%   |
| Other income  |      | 0.32    | 0.3%   |      | 0.26    | 0.3%   |
| Interest expense, cash  |      | (2.29)  | 1.9%   |      | (0.66)  | 0.7%   |
| Redemption accretion on convertible notes   |      | --      | --     |      | (5.38)  | 5.6%   |
| <b>Income before income taxes</b>   |      | 5.00    | 4.2%   |      | 2.20    | 2.3%   |
| Income taxes  |      | (1.72)  | 1.4%   |      | (0.20)  | 0.2%   |
| <b>Net income</b>   | \$   | 3.28    | 2.8%   | \$   | 2.00    | 2.1%   |

**Revenues**

Our revenues are generated from system installations and manufacturing and distribution of surveillance and safety products. During the first quarter of 2010, we experienced solid growth in revenues. Revenues increased from \$96.42 million for the first quarter of 2009 to \$120.19 million for the first quarter of 2010, representing a 24.7% increase. Such increase was mainly attributable to growth in the surveillance and safety market in China, the increased market demand for our products, our increased brand recognition and the acquisition of several companies in 2008 and 2009 as discussed in detail below. Our strategic efforts to increase our distribution channels during 2008 and 2009 and adequate working capital from prior fundraising activities with banks also allowed us to successfully take advantage of the growth in market demand in this quarter. Historically, the first quarter has generally been a slow quarter for us due to the Chinese New Year holiday and the fourth quarter has generally been the strongest quarter. Management expects the same trend in 2010 and that revenue growth will remain strong for the remainder of 2010.

After Coson became our wholly owned subsidiary, we consolidated the financial results of Coson beginning in the first quarter of 2009, which contributed \$0.82 million and \$0.83 million to revenues in the first quarter of 2010 and 2009, respectively. As the acquisitions of Stonesonic, Longhorn, Guanling, Jin Lin and DIT have all surpassed the one year anniversary, we have included the revenues contributed by these companies in our organic growth since the fourth quarter of 2009.

The following table shows the components of revenues recognized in the first quarter of 2010.

(In millions of U.S. dollars)

|  |    |        |
|--|----|--------|
| Revenues from the Installation Segment recognized from installation contracts signed in 2009   | \$ | 56.33  |
| Revenues from the Installation Segment recognized from installation contracts signed in the first quarter 2010                                 | \$ | 36.42  |
| Revenues from the Manufacturing Segment recognized from manufacturing contracts signed in 2009   | \$ | 1.29   |
| Revenues from the Manufacturing Segment recognized from manufacturing contracts signed in the first quarter of 2010                            | \$ | 14.72  |
| Revenues from the Distribution Segment recognized from distribution contracts signed in 2009   | \$ | 1.29   |
| Revenues from the Distribution Segment recognized from distribution contracts signed in the first quarter of 2010                              | \$ | 10.14  |
| Total revenues recognized in the first quarter of 2010   | \$ | 120.19 |
| Revenues deferred  | \$ | 2.03   |
| Backlog of contracts for system installation and manufacturing of surveillance and safety products signed before March 31, 2010 <sup>(1)</sup> | \$ | 199.72 |

<sup>(1)</sup> We have conservatively not included the letter of intents, framework agreements and various signed partnership agreements in our backlog numbers as they are subject to final binding individual agreements to be entered into at later dates.

Our revenues are generated from three business segments: Installation Segment, Manufacturing Segment and Distribution Segment. The following table shows the different segments comprising our total revenues for the three months ended March 31, 2010 and 2009.

All amounts in millions of U.S. dollars

| Revenues              | 2010 |        | 2009   |    |       |        |
|-----------------------|------|--------|--------|----|-------|--------|
| Installation Segment  | \$   | 92.75  | 77.2%  | \$ | 74.92 | 77.7%  |
| Manufacturing Segment |      | 16.01  | 13.3%  |    | 15.31 | 15.9%  |
| Distribution Segment  |      | 11.43  | 9.5%   |    | 6.19  | 6.4%   |
| Total                 | \$   | 120.19 | 100.0% | \$ | 96.42 | 100.0% |





For the three months ended March 31, 2010 and 2009, our Installation Segment generated revenues of \$92.75 million and \$74.92 million which represented 77.2% and 77.7% of our total revenues, respectively. The increase in revenues was mainly due to the following factors: First, demand for security and surveillance products has grown in China, which we attribute in part to the general rise in affluence of population in China. The increased demand within various industries and organizations, such as residential real estate, factories and shopping centers, also contributed to increased demand for surveillance and safety products. Second, the Chinese government initiated several programs and regulatory drivers, such as State Ordinance 458 and the 3111 program, that require many public places, including city-wide surveillance systems, traffic surveillance systems, critical government locations, cyber cafés, bars and discotheques, to install security systems. Third, our strategic efforts to increase our distribution channels during 2008 and 2009 allowed us to successfully take advantage of the growth in market demand in the first quarter of 2010. Fourth, in November 2008, the Chinese government announced an economic stimulus package to invest RMB 4 trillion (approximately \$586 billion) in infrastructure and social welfare by the end of 2010. The economic stimulus package increased the demand for surveillance and safety products in China. Fifth, we have been successful in raising sufficient working capital to facilitate expansion in the China market. Finally, our increased brand recognition also contributed to the growth in revenues.

For the three months ended March 31, 2010 and 2009, our Manufacturing Segment generated revenues of \$16.01 million and \$15.31 million, representing 13.3% and 15.9% of our total revenues, respectively. Such increase was primarily driven by the increase of overseas sales. For the three months ended March 31, 2010 and 2009, our Distribution Segment generated revenues of \$11.43 million and \$6.19 million, representing 9.5% and 6.4% of our total revenues, respectively. Such increase was primarily driven by the decrease of selling prices due to market competition which, in turn, increased sales volume. Management believes that revenues from the installation projects will continue to be the Company's major revenue source in the next few years. With the acquisition in 2009 and other planned acquisitions, management believes that the percentage of revenues from the Manufacturing Segment and the Distribution Segment will increase in the future.

Management expects growth in all three segments to remain strong in the remainder of 2010 due to (i) continued growth in the security and surveillance market both within the corporate and government sectors, (ii) strong branding and profiling in China, and (iii) acquisition strategy intended to boost our market share and competitiveness.

#### *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 first quarter of 2010 increased by 27.8% to \$91.21 million as compared to \$71.39 million for the same period last year. The increase was generally in line with the increase of revenues.

#### *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 increased \$3.95 million, or 15.8%, to \$28.98 million for the three months ended March 31, 2010 from \$25.03 million for the same period last year. Gross margin for the three months ended March 31, 2010 was 24.1%, as compared to 26.0% for the same period of 2009. The decrease in our gross margin was primarily driven by the decrease of sales prices. We made a strategic decision to decrease our sales prices in order to maintain our market share and expand our customer base.

The following table shows the different segment components comprising our gross profit margin over the three months ended March 31, 2010 and 2009.

| <b>Gross Margin</b>   | <b>2010</b> | <b>2009</b> |
|-----------------------|-------------|-------------|
| Installation Segment  | 24.8%       | 25.8%       |
| Manufacturing Segment | 27.8%       | 27.5%       |

|                      |       |       |
|----------------------|-------|-------|
| Distribution Segment | 13.0% | 23.6% |
| Total                | 24.1% | 26.0% |

For the three months ended March 31, 2010, gross margins of the Installation Segment, Manufacturing Segment and Distribution Segment were approximately 24.8%, 27.8% and 13.0%, compared to 25.8%, 27.5% and 23.6% for the same period last year, respectively. The decreased gross margin in the Installation Segment was primarily due to decrease of selling price and declining margins from smaller scale projects resulting primarily from our efforts in maintaining market share and expansion of customer base. Gross margin for the Manufacturing Segment increased to 27.8% for the three months ended March 31, 2010 from 27.5% for the same period last year. The slight increase in gross margin with respect to the Manufacturing Segment was primarily driven by increased bargaining power in the purchase of raw materials resulting from increased economies of scale. Gross margin for the Distribution Segment decreased to 13.0% for the three months ended March 31, 2010 from 23.6% for the same period last year. Such high gross margin in the same period last year was mainly because our software solutions that were sold during the same period last year, generally had a higher margin.

***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 remained stable at \$2.71 million for the three months ended March 31, 2010. As a percentage of revenues, our selling and marketing expenses decreased to 2.3% for the three months ended March 31, 2010 from 2.8% for the same period in 2009. The slight percentage decrease was due to cost efficiency.

***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 \$0.69 million, or 9.5%, to \$7.99 million for the three months ended March 31, 2010 from \$7.30 million for the same period in 2009. The dollar increase was mainly due to the hiring of additional staff and professional expenses related to consolidating our recently acquired subsidiary into the public reporting company. As a percentage of revenues, general and administrative expenses decreased to 6.6% for the three months ended March 31, 2010 from 7.6% for the same period in 2009. The percentage decrease was mainly due to cost efficiency.

***Non-cash employee compensation***

Non-cash employee compensation by segment for the three months ended March 31, 2010 and 2009 is as follows:

| <b><u>Non-cash employee compensation</u></b> | All amounts in millions of U.S. dollars |               |                |               |
|--|---|---------------|----------------|---------------|
|  | <b>2010</b>                             |               | <b>2009</b>    |               |
| Installation Segment                         | \$ 0.57                                 | 6.8%          | \$ 0.51        | 12.1%         |
| Manufacturing Segment                        | 0.94                                    | 11.3%         | 0.74           | 17.5%         |
| Distribution Segment                         | 0.36                                    | 4.3%          | 0.35           | 8.3%          |
| Corporate and Other                          | 6.46                                    | 77.6%         | 2.62           | 62.1%         |
| <b>Total</b>                                 | <b>\$ 8.33</b>                          | <b>100.0%</b> | <b>\$ 4.22</b> | <b>100.0%</b> |

Effective February 7, 2007, our board of directors adopted the 2007 Equity Incentive Plan (the Plan) which was subsequently amended in February 2010. 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 our Plan. The Plan has a 10-year term. During the three months ended March 31, 2010 and 2009, we granted an aggregate of 686,705 and 419,818 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 years.

Non-cash employee compensation for the three months ended March 31, 2010 increased to \$8.33 million from \$4.22 million for the same period in 2009, primarily because more shares were granted to employees and consultants under the Plan in this quarter.

***Depreciation and amortization***

Our depreciation and amortization costs increased \$0.17 million, or 5.6%, to \$3.23 million (including \$0.25 million depreciation and amortization costs included under cost of goods sold) for the three months ended March 31, 2010 from \$3.06 million for the same period in 2009. This increase was primarily due to the increased amortization cost of assets resulting from the acquired subsidiaries. As a percentage of revenues, depreciation and amortization expenses decreased to 2.7% for the three months ended March 31, 2010 from 3.2% for the same period in 2009. Such percentage decrease was primarily due to the increase in incremental revenue in this quarter.

***Income from operations***

Our income from operations decreased \$1.01 million, or 12.7%, to \$6.97 million for the three months ended March 31, 2010 as compared to \$7.98 million for the same period in 2009. As a percentage of revenues, income from operations decreased to 5.8% for the three months ended March 31, 2010 from 8.3% for the same period in 2009. Such dollar and percentage decrease was primarily due to the decrease of our gross margin and the increase of our general and administrative expenses and non-cash employee compensation as discussed above.

The following table shows the different segments comprising our income from operations for the three months ended March 31, 2010 and 2009.

| All amounts in millions of U.S. dollars |             |         |          |             |         |
|---|-------------|---------|----------|-------------|---------|
| <b>Income from operations</b>           | <b>2010</b> |         |          | <b>2009</b> |         |
| Installation Segment                    | \$          | 19.74   | 283.2%   | \$          | 14.00   |
|   |             |         |          |             | 175.4%  |
| Manufacturing Segment                   |             | (1.05)  | (15.1%)  |             | (0.46)  |
|   |             |         |          |             | (5.8%)  |
| Distribution Segment                    |             | (0.66)  | (9.5%)   |             | (0.38)  |
|   |             |         |          |             | (4.8%)  |
| Corporate and others                    |             | (11.06) | (158.6%) |             | (5.18)  |
|   |             |         |          |             | (64.8%) |
| Total                                   | \$          | 6.97    | 100.0%   | \$          | 7.98    |
|   |             |         |          |             | 100.0%  |

Income from operations related to the Installation Segment increased 41.0%, or \$5.74 million to \$19.74 million for the three months ended March 31, 2010, compared to \$14.00 million for the same period in 2009. Such increase was mainly due to higher demand of our total one-stop-shop installation from customers. We completed more projects in this quarter than the same quarter last year in an effort to expand our market share.

Loss from operations related to the Manufacturing Segment was \$1.05 million for the three months ended March 31, 2010, compared to the operating loss of \$0.46 million for the same period in 2009. Such increase was mainly due to the non-cash employee compensation related to the Manufacturing Segment. The Company expects that the Manufacturing Segment margin will increase as we integrate the recently completed acquisitions which will allow us to further benefit from economies of scale.

Loss from operations related to the Distribution Segment was \$0.66 million for the three months ended March 31, 2010, compared to the operating loss of \$0.38 million for the same period in 2009. Such increase was mainly due to the decrease of gross margin.

We also provide general corporate services to our segments. Costs attributable to these services are reported as corporate and other expenses. These costs include amortization, depreciation, and non-cash compensation for employees. For the three months ended March 31, 2010 and 2009, we incurred \$11.06 million and \$5.18 million in corporate and other expense, respectively. The increase was mainly due to the increase of non-cash employee compensation discussed above, and professional expenses related to the costs of integrating our subsidiaries into our public reporting company system.

#### ***Other income***

Our other income increased 23.1%, or \$0.06 million to \$0.32 million for the three months ended March 31, 2010 from \$0.26 million for the same period in 2009. As a percentage of revenues, other income for the three months ended March 31, 2010 was 0.3%, as compared to 0.3% for the same period in 2009.

#### ***Interest expense (excluding redemption accretion on convertible notes)***

During the first quarter of 2010, we borrowed funds under 18 short-term loans from banks and incurred total interest expense of \$1.34 million, as compared to \$0.38 million for the same period in 2009. For the guaranteed senior unsecured notes payable, we incurred \$0.95 million in interest during the three months ended March 31, 2010. For the convertible notes, we paid \$0.28 million in interest during the three months ended March 31, 2009. Such increase was primarily due to the increase in the outstanding balances of our bank loans.

#### ***Redemption accretion on convertible notes***

Redemption accretion on convertible notes for the three months ended March 31, 2010 and 2009 was \$0 and \$5.38 million, respectively. We raised \$110 million from the issuance of convertible notes in February and April 2007 which were retired and restructured into two new zero coupon interest notes on September 2, 2009.



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

Our income before taxes increased \$2.80 million, or 127.3%, to \$5.00 million for the three months ended March 31, 2010 from \$2.20 million for the same period in 2009. As a percentage of revenues, income before taxes increased to 4.2% from 2.3% for the same period in 2009. Such percentage increase was primarily due to decreased non-cash expenses related to the redemption accretion on convertible notes as discussed above.

### ***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 months ended March 31, 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.

Before January 1, 2008, foreign invested enterprises ( FIEs ) established in the PRC were generally subject to an enterprise income tax ( EIT ) rate of 33%, which included a 30% state income tax and a 3% local income tax. FIEs established in Shenzhen Special Economic Zone, such as our Chinese subsidiary, Golden, and certain high-technology companies were subject to a reduced tax rate. On March 16, 2007, the National People's Congress of China passed the new Enterprise Income Tax Law ( EIT Law ), and on November 28, 2007, the State Council of China passed the Implementing Rules for the EIT Law ( Implementing Rules ) which took effect on January 1, 2008. The EIT Law and Implementing Rules impose a unified EIT of 25% on all domestic-invested enterprises and FIEs, unless they qualify under certain limited exceptions. Therefore, nearly all FIEs are subject to the new tax rate alongside other domestic businesses rather than benefiting from the EIT, and its associated preferential tax treatments, beginning January 1, 2008.

Despite these changes, the EIT Law gives the Old FIEs a five-year grandfathering period during which they can continue to enjoy their existing preferential tax treatments. During this five-year grandfathering period, the Old FIEs which enjoyed tax rates lower than 25% under the original EIT Law shall gradually increase their EIT rate within 5 years until the tax rate reaches 25%. In addition, the Old FIEs that are eligible for the two-year exemption and three-year half reduction or five-year exemption and five-year half-reduction under the original EIT Law, are allowed to remain to enjoy their preference until these holidays expire. The discontinuation of any such special or preferential tax treatment or other incentives would have an adverse affect on any organization's business, fiscal condition and current operations in China.

In addition to the changes to the current tax structure, under the EIT Law, an enterprise established outside of China with de facto management bodies within China is considered a resident enterprise and will normally be subject to an EIT of 25% on its global income. The Implementing Rules define the term de facto management bodies as an establishment that exercises, in substance, overall management and control over the production, business, personnel, accounting, etc., of a Chinese enterprise. If the PRC tax authorities subsequently determine that the Company should be classified as a resident enterprise, then the organization's global income will be subject to PRC income tax of 25%.

Our subsidiary, Golden, is subject to an EIT rate of 22% for 2010. Hongtianzhi is located in Shenzhen and its 2010 EIT rate is 22% because it receives a lower tax rate as a high-technology company. Cheng Feng, HiEasy, Minking, and Stonesonic are each subject to an EIT rate of 15% in 2010 due to their high-technology or software company status. CSST PRC and Longhorn are located in Shenzhen and their 2010 EIT rate is 11% because they receive a lower tax rate as a high-technology company. Coson and Zhuhai DIT Digital Technology Limited are each subject to an EIT rate of 22% in 2010 due to their high-technology company status. Tsingvision and Jin Lin are subject to an EIT rate of 12.5% in 2010 due to their software company status. CSSM, CSSS, CSSD and Guanling are subject to an EIT rate of 25% in 2010.





Income taxes increased \$1.52 million to \$1.72 million for the three months ended March 31, 2010 from \$0.20 million for the same period of 2009. Such increase was primarily because of the increase in tax rate. The income tax exemption of some of our major subsidiaries expired as of the beginning of 2010.

### *Net income*

Net income increased \$1.28 million, or 64.0%, to \$3.28 million for the three months ended March 31, 2010 from \$2.00 million for the same period in 2009. As a percentage of revenues, net income increased to 2.8% for the three months ended March 31, 2010 from 2.1% for the same period in 2009. This percentage increase was mainly due to the decrease of non-cash expenses related to the redemption accretion on our convertible notes as discussed above.

### *Foreign Currency Translation Gains*

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

We incurred a foreign currency translation gain of \$0.12 million for the three months ended March 31, 2010 as compared with a foreign currency translation gain of \$0.05 million for the same period in 2009.

As we have done since China 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, we implemented different exchange rates in translating RMB into U.S. dollars in our financial statements for fiscal quarter ended March 31, 2010 and 2009.

For the three months ended March 31, 2010, the exchange rates of 6.83, 6.83 and 8.04 were implemented in calculating the assets and liabilities, revenue and expenses, and shareholders' equity, respectively, which results in a \$0.12 million foreign currency translation gain in the first quarter of 2010. In the first quarter of 2009, the exchange rates of 6.84, 6.84 and 8.04 were implemented in calculating the assets and liabilities, revenue and expenses, and shareholders' equity, respectively, which results in an \$0.05 million foreign currency translation gain in such period.

### *Liquidity and Capital Resources*

#### *General*

As of March 31, 2010 and December 31, 2009, we had cash and cash equivalents of \$142.29 million and \$154.48 million, respectively. The following table provides detailed information about our net cash flow for the three months ended March 31, 2010 and 2009.

#### **Cash Flow**

All amounts in millions of U.S. dollars

|   | <b>2010</b> | <b>2009</b> |
|---|-------------|-------------|
| Net cash (used in) provided by operating activities | \$ (60.88)  | \$ 21.44    |
| Net cash used in investing activities               | (7.66)      | (2.81)      |
| Net cash provided by financing activities           | 56.34       | 5.95        |
| Effect of exchange rate changes on cash             | 0.01        | 0.11        |
| Net cash (outflow) inflow                           | \$ (12.19)  | \$ 24.69    |

#### *Operating Activities:*

Net cash used in operating activities was \$60.88 million for the three months ended March 31, 2010, as compared to \$21.44 million of the net cash provided by operating activities for the same period in 2009. The change in net cash

used in operating activities was mainly due to increases in accounts receivable and advances to suppliers.

**Investing Activities:**

Our main uses of cash for investing activities during the first quarter of 2010 were deposits for the acquisition of subsidiaries and businesses and for property, plant and equipment.

Net cash used in investing activities for the three months ended March 31, 2010 was \$7.66 million, which is an increase of \$4.85 million from net cash used in investing activities of \$2.81 million in the same period of 2009. Such increase was primarily due to increased deposits for acquisitions of subsidiaries in the first quarter of 2010.

**Financing Activities:**

Net cash provided by financing activities in the three months ended March 31, 2010 totaled \$56.34 million as compared to \$5.95 million used in financing activities in the same period of 2009. The net cash provided by financing activities was mainly attributable to the additional bank loans raised in the first quarter of 2010.

**Loan Facilities:**

As of March 31, 2010, the amount, maturity date and term of each of our bank loans are as follows:

All amounts in millions of U.S. dollars

| <b>Lender</b>                           | <b>Amount</b>    | <b>Maturity Date</b> | <b>Duration</b> |
|---|------------------|----------------------|-----------------|
| China Merchants Bank                    | \$ 7.33          | March 2011           | 1 year          |
| China Citic Bank                        | 13.18            | March 2011           | 1 year          |
| China Citic Bank                        | 8.79             | March 2011           | 1 year          |
| Industrial and Commercial Bank of China | 4.54             | March 2011           | 1 year          |
| Industrial and Commercial Bank of China | 5.71             | March 2011           | 1 year          |
| China Construction Bank                 | 7.33             | March 2011           | 1 year          |
| China Merchants Bank                    | 6.00             | March 2011           | 1 year          |
| Bank of China                           | 7.03             | February 2011        | 1 year          |
| Bank of China                           | 10.99            | February 2011        | 1 year          |
| Societe Generale                        | 3.96             | August 2010          | 6 months        |
| China Merchants Bank                    | 8.64             | February 2011        | 1 year          |
| Industrial and Commercial Bank of China | 14.65            | January 2011         | 1 year          |
| Bank of China                           | 10.99            | January 2011         | 1 year          |
| Bank of Ningbo                          | 4.39             | December 2010        | 1 year          |
| Industrial and Commercial Bank of China | 7.33             | November 2010        | 1 year          |
| Shenzhen Development Bank               | 2.93             | September 2010       | 1 year          |
| China Construction Bank                 | 4.39             | August 2010          | 1 year          |
| China Everbright Bank                   | 5.86             | May 2010             | 1 year          |
| A Financial Institution                 | 0.69             | February 2013        | 4 years         |
| A Financial Institution                 | 6.23             | September 2012       | 3 years         |
| A Financial Institution                 | 3.56             | July 2011            | 3 years         |
| <b>Total</b>                            | <b>\$ 144.52</b> |                      |                 |

*a) Notes payable*

On March 31, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB50 million (approximately \$7.33 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our CEO, his wife, and our subsidiary, and is 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 million (approximately \$13.18 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our CEO, his wife and our subsidiary, and properties of two subsidiaries.

On March 24, 2010, we entered into a loan agreement with China Citic Bank. We borrowed RMB60 million (approximately \$8.79 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our CEO, his wife and our subsidiary, and properties of two subsidiaries.

On March 4, 2010, we entered into a loan agreement with Industrial and Commercial Bank of China. We borrowed RMB31 million (approximately \$4.54 million) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our three subsidiaries, and is collateralized by property of a subsidiary.

On March 4, 2010, we entered into a loan agreement with Industrial and Commercial Bank of China. We borrowed RMB39 million (approximately \$5.71 million) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our three subsidiaries, and is collateralized by property of a subsidiary.

On March 3, 2010, we entered into a loan agreement with China Construction Bank. We borrowed RMB50 million (approximately \$7.33 million) with an annual interest rate equal to 5.58%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our CEO and our subsidiary, and is collateralized by property of a subsidiary.

On March 2, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB41 million (approximately \$6.00 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in March 2011. The loan is guaranteed by our CEO, his wife, and our subsidiary, and is collateralized by the property and land use rights of a subsidiary.

On February 26, 2010, we entered into a loan agreement with Bank of China. We borrowed RMB48 million (approximately \$7.03 million) with an annual interest rate equal to 5.04%, with interest payable on the 20th of each month. The loan is due in November 2010. The loan is guaranteed by our CEO and our two subsidiaries, collateralized by the property and land use rights of a subsidiary.

On February 11, 2010, we entered into a loan agreement with Bank of China. We borrowed RMB75 million (approximately \$10.99 million) with an annual interest rate equal to 5.84%, with interest payable on the 20th of each month. The loan is due in February 2011. The loan is guaranteed by our CEO and our two subsidiaries, collateralized by the property and land use rights of a subsidiary.

On February 8, 2010, we entered into a loan agreement with Societe Generale. We borrowed RMB27 million (approximately \$3.96) with an annual interest rate equal to 4.86%, with interest payable on the due date of the loan. The loan is due in August 2010. The loan is guaranteed by our subsidiary.

On February 3, 2010, we entered into a loan agreement with China Merchants Bank. We borrowed RMB59 million (approximately \$8.64 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in February 2011. The loan is guaranteed by our CEO, his wife, and our subsidiary, and is collateralized by the property and land use rights of a subsidiary.

On January 26, 2010, we entered into a loan agreement with Industrial and Commercial Bank of China. We borrowed RMB100 million (approximately \$14.65 million) with an annual interest rate equal to 4.78%, with interest payable on the 20th of each month. The loan is due in January 2011. The loan is guaranteed by our CEO.

On January 7, 2010, we entered into a loan agreement with Bank of China. We borrowed RMB75 million (approximately \$10.99 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in January 2011. The loan is guaranteed by our CEO and our two subsidiaries, and is collateralized by the property and land use rights of a subsidiary.

On December 25, 2009, we entered into a loan agreement with Bank of Ningbo. We borrowed RMB30 million (approximately \$4.39 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in December 2010. The loan is guaranteed by our CEO and our subsidiary.

On November 6, 2009, we entered into a loan agreement with Industrial and Commercial Bank of China. We borrowed RMB50 million (approximately \$7.33 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in November 2010. The loan is guaranteed by our three subsidiaries, and is collateralized by the land use rights and property of a subsidiary.

On September 30, 2009, we entered into a loan agreement with Shenzhen Development Bank. We borrowed RMB20 million (approximately \$2.93 million) with an annual interest rate equal to 105% of benchmark lending rate (5.5755% as of March 31, 2010), with interest payable on the 20th of each month. The loan is due in September 2010. The loan is guaranteed by our CEO and our two subsidiaries, and is collateralized by the property of a subsidiary.

On August 13, 2009, we entered into a loan agreement with China Construction Bank. We borrowed RMB30 million (approximately \$4.39 million) with an annual interest rate equal to 5.5755%, with interest payable on the 20th of each month. The loan is due in August 2010. The loan is collateralized by the property of a subsidiary.

On May 20, 2009, we entered into a loan agreement with China Everbright Bank Co., Ltd. We borrowed RMB40 million (approximately \$5.86 million) with an annual interest rate equal to 5.31%, with interest payable on the 20th of each month. The loan is due in May 2010. The loan is guaranteed by our CEO, our subsidiary, and Chuang Guan.

***b) Product financing arrangements***

In September 2009, we entered into product financing arrangements 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 \$7.32 million). The loans expire in September 2012, and payments are due at the end of each quarter. As of March 31, 2010, the outstanding liability relating to this loan was RMB42.52 million (approximately \$6.23 million).

In February 2009, we entered into product financing arrangements 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 \$1.04 million). The loans expire in February 2013, and payments are due at the end of each quarter. As of March 31, 2010, the outstanding liability relating to this loan was RMB4.69 million (approximately \$0.69 million).

In July 2008, we entered into product financing arrangements with a financial institution. Under the terms of the agreements, we agreed to pay an annual interest rate of 10% on inventory financings. We borrowed RMB53 million (approximately \$7.85 million). These loans mature in July 2011. The interest is payable at the end of each quarter. As of March 31, 2010, the outstanding liability relating to these arrangements was RMB24.31 million (approximately \$3.56 million).

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

As of March 31, 2010, we have outstanding Tranche B Zero Coupon Guaranteed Senior Unsecured Notes (the Tranche B Notes ). The Tranche B Notes had 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, starting 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 the applicable laws. We repaid \$19.32 million of the principal on the Tranche B Notes in March 2010.

**d) Others**

In March 2009, Industrial and Commercial Bank of China ( ICBC ) confirmed that it would acquire all accounts receivable from our Kunming Safe City project and cash payment would be made without delay once the project is completed and passes inspection. The Kunming Municipal Government will then make full payment to ICBC in installments over a five-year period.

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 the Company 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 the Company; 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.

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

**Obligations Under Material Contracts**

Below is a table setting forth our material contractual obligations as of March 31, 2010:

All amounts in millions of U.S. dollars

|                                | Total     | Payments due by period |           |           |                      |
|--------------------------------|-----------|------------------------|-----------|-----------|----------------------|
|                                |           | Less than 1<br>year    | 1-3 years | 3-5 years | More than 5<br>years |
| Debt Obligations               | \$ 210.34 | \$ 178.39              | \$ 31.95  | \$ --     | \$ --                |
| Operating Lease<br>Obligations | 2.21      | 0.93                   | 1.28      | --        | --                   |
| Total                          | \$ 212.55 | \$ 179.32              | \$ 33.23  | \$ --     | \$ --                |

***Recent Accounting Pronouncements***

Accounting for Transfers of Financial Assets

*(Included in ASC 860 Transfers and Servicing )*

This ASC guidance addresses information a reporting entity provides in its financial statements about: the transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. Also, ASC 860 removes the concept of a qualifying special purpose entity, limits the circumstances in which a transferor derecognizes a portion or component of a financial asset, defines participating interest and enhances the information provided to financial statement users to provide greater transparency. This guidance was effective for us as of January 1, 2010. The adoption of this guidance had no impact on our consolidated financial statements.

Consolidation of Variable Interest Entities — Amended

*(Included in ASC 810 Consolidation )*

Revisions under ASC 810, require an enterprise to perform an analysis to determine the primary beneficiary of a variable interest entity; require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity; and eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity. This ASC guidance also requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity. This guidance was effective for us as of January 1, 2010. The adoption of this guidance had no impact on our consolidated financial statements.



**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 will be effective for us in the first quarter of 2011. Early adoption is permitted. We are currently evaluating the impact that the adoption of this standard may have on our consolidated financial statements.

***Critical Accounting Policies***

See Item 7, Management's Discussion and Analysis of Results of Operations and Financial Condition in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, for a discussion of the Company's critical accounting policies.

***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***

The Company deposits surplus funds with Chinese banks earning daily interest. The Company does not invest in any instruments for trading purposes. All of the Company's outstanding debt instruments carry fixed rates of interest. The Company's operations generally are not directly sensitive to fluctuations in interest rates. The amount of long-term debt outstanding as of March 31, 2010 and December 31, 2009 was \$30.36 million and \$50.53 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 March 31, 2010 would not have any material impact on our net income before provision for income taxes for the quarter. 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 shareholders 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 shareholders equity. An average appreciation (depreciation) of the RMB against the U.S. dollar of 5% would increase our comprehensive income by \$0.12 million based on our outstanding revenues, costs and expenses, assets and liabilities denominated in RMB as of March 31, 2010. As of March 31, 2010, our accumulated other comprehensive income was \$27.69 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**

*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 March 31, 2010. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of March 31, 2010.

*Changes in Internal Control over Financial Reporting.* There has been no change to our internal control over financial reporting during the quarter ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## PART II

### OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

From time to time, we may have disputes that arise in the ordinary course of its 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.

#### ITEM 1A. RISK FACTORS

There are no material changes from the risk factors previously disclosed in Part I, Item 1A. "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the SEC on March 2, 2010.

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

None.

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

#### ITEM 5. OTHER INFORMATION

None.

#### ITEM 6. EXHIBITS

| Exhibit Number | Description |
|----------------|-------------|
|----------------|-------------|

|             |   |
|-------------|---|
| <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> |

**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: April 26, 2010

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

By: /s/ Guoshen Tu  
Principal Executive Officer

By: /s/ Terence Yap  
Principal Financial Officer

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