

**China Fire & Security Group, Inc.**  
**First Quarter 2010 Earnings**  
**May 10, 2010**

**Operator:** Good day and welcome to the China Fire & Security Group First Quarter 2010 Earnings Conference call. Please be aware that today's conference is being recorded.

At this time, I would like to turn the conference over to Robert Yuan, Principal Accounting Officer of China Fire & Security Group. Please go ahead, sir.

**Robert Yuan:** Thank you, Stephanie. Thank you everyone, for joining us for the China Fire & Security Group's First Quarter 2010 Earnings call. With us today is Brian Lin, China Fire's Chief Executive Officer, and Robert Yuan, China Fire's Principal Accounting Officer.

Before we get started, I am going to review the Safe Harbor statement regarding today's conference call. This conference call may contain, in addition to historical information, forward-looking statements within the meaning of the federal securities laws regarding China Fire. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, other than statements that are historical in nature. These forward-looking statements are based on current management's expectations and are subject to risks and uncertainties that may result in expectations not being realized and may cause actual outcomes to differ materially from expectations reflected in these forward-looking statements. Potential risks and uncertainties include product and service demand acceptance, changes in technology or economic conditions, the impact of competition and pricing, the impact of government regulations and other risks contained in the statements filed from time to time with SEC. All such forward-looking statements, whether written or oral and whether made by or on behalf of the Company, are expressly qualified by the cautionary statements, because forward-looking statements are subject to risks and uncertainties, we caution you not to place undue reliance on these statements. Forward-looking statements made during this conference call only represent management's estimates as of today, May 10, 2010. China Fire & Security Group assumes no obligation to update these projections in the future as market conditions change.

For those of you unable to listen to the entire call at this time, a recording will be available via webcast for 360 days on our corporate website, [www.chinafiresecurity.com](http://www.chinafiresecurity.com).

At this point, I would like to introduce Brian Lin, CFO of China Fire & Security Group. Brian?

**Brian Lin:** Thank you very much, Robert. Good morning, everyone, to those in the U.S., and good evening to those participants in Asia. Welcome to our First Quarter 2010 Conference Call. Today we will discuss our financial results in the first quarter, talk about our recent developments and conclude with our guidance for full year 2010.

In the first quarter of 2010, we are pleased to report that we continue to grow our core business and further strengthen our leading position in industrial fire protection industry in China. Before we get into the details of our first quarter 2010 financial results, I would like to review with you some highlights during this quarter.

We have successfully signed and executed our first retrofitting contract of \$92 million, with Wuhan Iron and Steel Group, in the first quarter. Our board of directors appointed Mr. Weigang Li as the Chairman of the Board of Directors. Mr. Li is a founding member of China Fire and the driving force in our sales achievement.

We achieved record revenue of \$20.9 million, an increase of 4.2 million or 25.3% over the same period of last year. Our gross profit was 55.5%, up from 48.8% of the previous quarter. On non-GAAP basis, which excludes non-cash options and restricted stock expenses of net profit, was 6.3 million, representing 6.7% growth over the same period last year.

We initiated a new marketing campaign to promote the importance of retrofitting services in iron steel industry, leveraging our recent contract win with Wuhan Iron and Steel.

At this point, however, let me turn the call over to Robert for a detailed discussion of our first quarter financial results. Afterwards, I will return to discuss our recent developments and our strategic plan, and, finally, conclude with our guidance for full-year 2010. Robert?

**Robert Yuan:** Thank you Brian. In the first quarter of 2010, we once again solidly grew our business and maintained a strong balance sheet. Our revenue for the first quarter of 2010 includes 25.3% to \$20.9 million, compared to \$16.7 million, for the first quarter of 2009. This increase was primarily driven by an increase in all our business segments, including system contracting projects, product sales and maintenance service, and the successful implementation of the Wuhan Iron and Steel retrofitting contract during the period.

In the first quarter of 2010, we recognized revenues from 197 Total Solutions total sales and the maintenance contract in the first

quarter 2010, compared to 212 contracts, during the same period 2009. The three largest Total Solutions projects were from Wuhan Iron and Steel Group, Jinan Iron and Steel Group, Tiron (phon) Iron and Steel Group, who each collectively contributed approximately \$14.2 million of revenues were presenting 67.9% of all total revenues. Our first quarter gross margin was 55.5%, compared to our gross margin of 51.6% during the same period of 2009. The decrease in our gross margin was primarily due to the different contract mix during the period. Since the company's gross margin during each quarter, is determined by the revenue-weighted average of gross margins, which were contributed by different contracts, executed during the period. In a given quarter, if more revenue was recognized from contracts with high gross margins, this quarter will result in a higher gross margin.

Our operating expenses were \$5.5 million for the first quarter of 2010, compared to \$4.1 million, for the same period of 2009. The significant increase in our operating expenses was mainly due to the increase of \$0.8 million in our non-cash expenses, related to the option and the restricted stock expenses, during this quarter, including non-cash expenses. Our operating expenses only increased 17.0% on annual basis, which is lower than our top line growth. Our operating income for the first quarter was \$6.1 million, compared to \$6.2 million, from the same period last year. Our GAAP net income for the first quarter 2010, was \$5.2 million, as compared to \$5.6 million, for same period 2009. We're presenting an annual decrease of 7.1%. The decrease in our GAAP net income was mainly attributable to the lower gross margin and the higher operating expenses during the period. As a result, our fully diluted EPS was \$0.19 in the first quarter of 2010, versus \$0.20 in the first quarter of the previous year. On a non-GAAP basis, which excludes non-cash options and restricted stock expenses, our net profit was \$6.3 million, during the first quarter of 2010, compared to \$5.9 million during the first quarter of 2009. We're presenting an annual growth of 6.7%. Our non-GAAP fully diluted EPS was \$0.22, compared to \$0.21, during the same period 2009.

As of March 31, 2010, our total backlog was \$141 million. Out of that backlog, iron and steel industry was still the major vertical contributing approximately 73% while additional powers and regions contributed approximately 16% of current backlog. Petrochemicals, nuclear and other verticals, together, will present as the remaining 11% of our current backlog. We expect to convert a majority of the current backlog to revenue in the next nine months.

Now, I would like to turn your attention to our balance sheet and cash flow and I would like to only, specifically, address nine items that have significantly changed or that I believe to have material impact to our ongoing operations.

As of March 31, 2010, we had cash and cash equivalents of \$25.1 million, a sequential decrease of \$9.8 million, from \$34.9 million, at end of 2009. During the first quarter, we used \$10.1 million cash for our operations, as compared to a positive operating cash flow of \$2.5 million, in the same period last year. This quarterly decrease in our cash position and the negative, are putting cash flow, during the first quarter of 2010, was due to a temporary delay in the mutual payment of \$18 million US for Wuhan Iron and Steel retrofitting project. We expect the receipt of the initial payment within the second quarter of this year.

From an annual point of view, we are still very confident to maintain a positive operating cash flow during 2010. At March 31<sup>st</sup> 2010, our net accounts receivable totaled \$31.9 million, increased slightly by \$0.9 million, sequentially, from \$31 million of last quarter. Our days sales outstanding or DSOs, were 137 days for the first quarter of 2010, compared to 165 days of last quarter. Accordingly, our working capital, increased slightly by approximately \$0.7 million, to \$94.3 million, up from \$87.1, at the end of the fourth quarter 2009.

We currently have no bank loans or long-term debt and, as such, our total shareholder equity increased sequentially by \$6.2 million to \$110.6 million as of March 31<sup>st</sup>, 2010.

With that said, let me turn the call back to Brian for a discussion on our recent developments and our strategic plans. Brian, please.

**Brian Lin:** Thank you, Robert. Let me now share with you our recent developments, as well as specific macroeconomic trends that continue to validate our plans in future.

As we have discussed in our previous earnings calls, our strategy needs to continue to develop and capture opportunities in providing Fire Protection Total Solutions to high-end customers in the iron and steel industry and other infrastructure-related industries. We aim to further expand our major breakthroughs in the retrofitting and maintenance services domain and to capitalize on the industry's continued consolidation, as we have learned that the Chinese government began to implement the newly revised Fire Prevention Law The Peoples Republic of China, on May 1<sup>st</sup> 2009, which extended its previously mandatory National Standards of the Code of Design of Fire Protection and Prevention for Iron and Steel Enterprises, enacted on January 1, 2008. The combination of these new regulations, strictly encourages iron and steel groups to update their fire safety facilities.

From the cap ex perspective, while the Chinese government has taken measures to curb a potential supply over-capacity, we have seen that many key one iron and steel groups have shifted their cap ex

based project to those innovating and updating their existing capacities. With a total annual output of 300 million tons from the major iron and steel companies in China, and with strong support of the Chinese government, China's massive iron and steel industry will likely accelerate retrofitting outdated fire safety systems in the near future. We estimate this market can total \$2 billion.

We have gained lots of experience and confidence as we successfully won the retrofitting contract with Wuhan Iron and Steel Group. We believe we will secure more retrofitting contracts in the iron and steel industry in the near future.

In addition to the business opportunities from retrofitting markets, there are also opportunities in the new build-up of iron steel capacity, driven by the consolidation and relocation process in the industry. According to Chinese press, there are certain significant progresses with (inaudible) steels projected build-up of a 10 million ton iron and steel plant, by phasing out dated capacity of almost 10 million tons in Guangdong province. While steel is not adding new capacity but will increase new product offerings and greatly improve the productivity efficiencies and environmental protections, once it completes the build-up by 2010, with an estimated investment of \$4.4 billion. This project is considered as a relocation of existing plants, rather than a new capacity build-up.

After discussing our recent development in the iron and steel industry, next, let me share with you our thoughts into expanding into new verticals, by regional, international markets. Let's look at the power vertical first.

We have continued to expand our customer base in the power sector, including thermal, hydro, nuclear power and power transmission grid. In 2008, China invested more than \$576 billion R&D in infrastructure construction of power industry, of which, investment in the nation's power grid infrastructure accounted for more than 50% of the total infrastructure investment, exceeding total investments in power generation. In 2009, our data indicates that from January to September, investments in electricity-related construction improved by 19% year-over-year to more than \$219 billion R&D by 2010, with the expected completion of construction for ultra-high voltage electric grid cross-region transmission capacity, will reach 70 million kilowatts, which is fivefold of the capacity in 2005.

The continued development of the nation's electric grid has quickly accelerated the construction of large-scale substations and high-voltage cable tunnels, with underground power cables with extremely high operating temperatures in narrow storage space, required managed fire protection solutions, representing considerable business opportunities for China Fire.

We are very excited about this growing market and believe that China Fire will directly benefit from the infrastructure development and upgrade. Recognizing these potential markets, we have been actively investing to expand our vertically focused technical and sales team for this sector. We anticipate strong growth in these verticals in 2010 as we have strong track records in all segments of power industry and have a portfolio of proprietary products that are critical components of the Fire Protection Solutions.

Next is the transportation vertical. China Fire continues to pursue business opportunities in transportation vertical, as China continues to invest in infrastructure-related projects such as subways, railways, ships and marine. A speech by National Development and Research Commission in March of this year, announced that 33 cities have plans for subway construction, 28 of which have been approved by the State Council. According to the State Council, China is going to build 480 kilometers of subways in 2010, with an investment of \$32 billion.

The total investment from the year 2010 to 2015 will reach \$176 billion. So far, China Fire primarily sells our proprietary linear heat detectors and certain fire suppression products to other system integrators who provide integrated systems to subways in Beijing, in Nanjing and in Wuhan. We are selectively pursuing business opportunities in providing turnkey solutions for subways, where we could generate more revenues and profits.

In the ships and marine industry, the first Chinese shipping industry investment fund has been officially launched with an overall investment of \$20 billion R&D. The purpose of this fund is to provide financial support for the development and reform of Chinese ship and marine industry. This investment all represents potential revenue opportunities for China Fire in the long term, as they all require fire protection products and services. Targeting this lucrative market, we started to work with the Marine Design and Research Institute to set up a plan to make an entry into this vertical. China Fire is optimistic to make some big moves in the new marine and shipping industry in the near future, with our patented and proprietary products.

And finally, the international market. As we mentioned before, we have been actively developing our business in the international market, especially India. With a double digit GDP growth rate target, the Indian government is making significant investments in domestic infrastructure to spur its economic growth, including large scale construction and upgrades for national power plants, iron steel plants and transportation systems. The Indian government is planning to double its investment in infrastructure in the next five years, according to the latest announcement by the Prime Minister of the Indian government, recently, which translates into another \$500 billion US focusing on power, transportation and so on. This presents us with significant

business opportunities in expanding our presence in the Indian market, in 2010 and beyond. We aim to make additional progress and make our patented linear heat detectors and water mist systems into this market, as we also leverage our core products and Total Solution packages. We are very confident that our UL certified proprietary patented products, will allow China Fire to further solidify our competitive position, enhance our brand awareness, and secure more contract wins in the international market. While trying to further promote our brand in the Indian power market, China Fire will also try to expand into Indian iron and steel industry.

Let's now look at the outlook for 2010. For the full-year 2010, the company reaffirms its projections that revenue will grow between 66% and 78%, to a range of \$135 million to \$145 million. Net income is expected to grow, between 89% to 105%, to a range of \$47 million to \$49 million, or \$1.65 to \$1.70, per diluted share.

In closing, we continue to be excited with our growth prospects in our core iron and steel market and customer base. We are excited that the new retrofit market opportunities are essentially an extension of our core iron and steel business, as the projects require our same core products, core technical and vertical expertise, that have made China Fire the market leader, with a number one brand in China.

This concludes my prepared remarks for the first quarter of 2010. Operator, we will now open the call up for questions.

**Operator:** Thank you. The question and answer session will be conducted electronically. If you would like to ask a question, please do so by pressing the star key, followed by the digit one on your touchtone telephone. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. And once again, press star, one to ask a question and we'll pause for just one moment.

Our first question comes from John Ma with Roth Capital Partners.

**John Ma:** Good evening, Robert, William and Brian.

**Robert Yuan:** Hi, John.

**Brian Lin:** Hi, John.

**John Ma:** Can you hear me?

**Robert Yuan:** Yes.

**Brian Lin:** Yes.

**John Ma:** Yeah, I have a couple of questions. First of all, regarding your Wuhan steel project, you know, you list the top—you talked about your—some of your major contracts in your remarks, but just wondered how much have you completed for your Wuhan project in first quarter and what percentage do you expect to be complete in second quarter?

**Robert Yuan:** Hi John. For the individual project, we usually don't disclose that and the certain amount.

**John Ma:** Can we—do we expect the two or three progressively will have a more revenue recognition?—as to the last year?

**Brian Lin:** The revenue recognition for Wuhan steel project will be debt unloaded in 2010. In other words, we'll see more revenue recognized towards the second half of the year, versus the first half of the year. We will be able to recognize a majority—more than 50% of revenues in 2010 will be the Wuhan Steel project.

**John Ma:** Okay, now, the second question relates to the steel industry overall. Now there's some concern over the cool down in real estate, which can impact the steel industry and also the iron ore price rising significantly, so would that cause these steel makers to put a hold on their retrofitting projects or upgrades. They have a, you know, is it given business outlook?

**Brian Lin:** I think when we look at the financial reports of most of the major iron and steel companies in China, the profitable now, quarter-over-quarter, yes, I think there are increases in iron ore prices, but again, the prices of the product are also increasing. So I think the key thing here is the cap ex spending of the iron and steel industries. They are still investing for the growth of the business and just using one of the customers of ours; they're still spending about \$20 billion R&D of cap ex in 2010, so I think now we've got some inside information on many of our customers (inaudible) they still have their cap ex spending budget for 2010.

**John Ma:** Good. Last question is the stock compensation. Will we see the similar level of stock compensation expense for future quarters, and if so, for how long?

**Brian Lin:** For (inaudible) option and restricted stock expenses, each quarterly, probably runs expense about \$1 million US and I think they will last for the next three years.

**John Ma:** Okay, thank you and congratulations.

**Brian Lin:** Thank you.

**Robert Yuan:** Thanks John

**Operator:** Once again, to ask a question, press star, one.

And it appears we have no further questions at this time. At this time I'd like to turn (unintelligible). Go ahead, sir.

**Robert Yuan:** On behalf of the entire China Fire & Security management team, we want to thank you for your interest and participation on this call. If you have any interest in visiting our office in Beijing, please let us know. Thank you for joining us today. This concludes our First Quarter 2010 Conference Call.

**Operator:** Once again, that does conclude today's conference. Thank you for calling.