Above the storm…

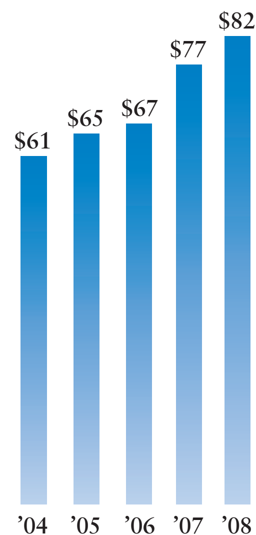
2008 Annual Report

Corporate Profile

Originally founded in 1873, AFA has provided over 135 years of uninterrupted Central Station Alarm Service to its customers.

AFA's Central Station service consists of a detecting system installed in subscribers' premises and frequently owned, serviced, monitored and maintained by AFA. The vast majority of signals from subscribers' premises are transmitted to AFA's Central Stations via subscribers' telephone lines, long-range radio or over the Internet. AFA presently operates UL Listed and FM Approved state-of-the-art computerized Central Stations servicing the Eastern United States. These Stations are staffed twenty-four hours a day and monitor approximately 30,000 AFA subscriber locations. The Company also monitors approximately 12,000 locations for customers of approximately 150 Alarm Dealers who do not have their own central stations. In some areas, systems may also be directly connected to Police or Fire Departments. Upon receipt of alarms, AFA personnel take the necessary action, which may include alerting Fire or Police Departments, notifying its subscribers and dispatching AFA personnel or other response agents to the protected premises.

Total Revenue
(in millions)



The Primary Scope of AFA's Services Includes:

- Burglar and vandalism protection;
- Monitoring of subscriber-owned systems;
- Sump pump and air conditioning supervision;
- Flood detection;
- Sprinkler alarm supervision;
- Access control systems;
- Investigator response;
- Fire detection systems;
- Industrial process supervision, including temperature;
- Closed circuit TV (CCTV) systems;
- Boiler supervision;
- Smoke detection;
- Maintenance and testing of high-rise life safety systems.

The majority of the Company's revenues comes from the sale and installation of specialized alarm systems including sophisticated high-rise fire and life safety systems which the Company designs and installs to meet proliferating fire and life safety codes.

AFA does not manufacture detecting equipment. Technology continues to change rapidly and new equipment is so readily available that AFA can better meet subscribers' needs by selecting the finest quality products available from the industry's top suppliers.

AFA's core revenues include the recurring annual service fees paid by customers for Central Station and inspection and maintenance services.

AFA's National Accounts Division continues to add dynamic growth to the Company. The division concentrates on providing fire and security protection to various retail chain stores throughout the United States.

Letter To Our Shareholders

In the wake of the economic turmoil that has enveloped the world since last summer, I am pleased to report that during 2008 the Company was able to meet our lofty expectations for the year. In fact, while so many companies experienced downturns and failures during this period, the Company stayed above the storm and had one of its best years ever. This performance is a tribute to our business plan, our employees, and the time-tested recession-resistant nature of our industry.

Net income in 2008 amounted to $2,577,000 or $16.80 per share as compared to $1,624,000 or $10.57 per share in 2007. Cash flow from operating activities in 2008 amounted to $6,867,000 or $44.75 per share compared to $1,811,000 or $11.79 per share in 2007. The Company's 2008 income and cash flow results included the recovery of prior expenses and interest related to the successfully concluded litigation with the New York City Fire Department. It is important to note, however, that even after extracting that one-time event, the Company's income and cash flow in 2008 still exceeded that of 2007. Revenues in 2008 were $81,807,000 as compared to $76,595,000 in 2007.

Armed with our largest backlog ever going into the year, our operations departments continued to install new jobs and revenues at record levels, more than offsetting losses incurred. Not only did this generate our highest total of reported revenues ever, but it led to our largest internal growth of recurring revenue in history, amounting to $1.4 million. This equated to a 6% year-to-year increase, more than doubling our best performance since operating as an independent company. We believe accomplishing this feat in such uncertain times was our most remarkable achievement in 2008. It also represented the tenth consecutive year in which the Company generated internal recurring revenue growth.

This growth in recurring revenue was accomplished despite a somewhat disappointing attrition rate of 9%. Still, our attrition rate continued to rank among the best in the industry, which reportedly ran on average between 12 and 15%. Two factors contributed to the Company's higher than normal attrition rate. The first factor, accounting for nearly one tenth of the total attrition, was the Company's September, 2008, completion of its program to convert all remaining New York subscribers still utilizing costly McCulloh transmission systems. Although we were successful in converting the vast majority of those subscribers, we chose to cancel all accounts not agreeing to convert in 2008 because of the disproportionately high cost of continuing such service as well as facing the likelihood that those transmission systems would not be supported in the near future. Obviously, there will be no further losses for this reason in 2009 or beyond. The second factor was a perceptible increase in losses due to competition. We believe this factor was caused by the economy, resulting in more customers affirmatively looking to cut costs. In addition, competitors, finding it more difficult to generate new business, looked to lure subscribers of other companies as an alternative. It is probable that this increased competitive activity will continue throughout the duration of the economic slowdown. Conversely, we hope to be able to offset some of these losses with new sales originating from competitors' subscribers.

Sales of new business approached $45 million or about 11% less than the prior year's record total. Conspicuously absent during 2008 were any individual large sales such as those experienced during 2007. Also, as could be expected, new sales slowed somewhat in response to the national economic downturn. Still, the Company's total sales for the year ranked among our best ever, and our year end backlog was our second highest ever, finishing at $16 million.

Bucking the downward trend of new sales was our National Accounts Division, which experienced a 4% increase in sales during 2008. This division was successful on all fronts. Not only did it add five new accounts, but it also executed multi-year extension agreements with all of its principal accounts. The new sales generated by this branch, including over $1 million in recurring revenues, were a major factor in our overall success.

Individual branch reports were varied. The New York office experienced a decrease in overall sales but realized a huge 70% increase in sales of recurring revenues. This helped the branch realize a net increase in recurring revenues for the year, which was most impressive considering that all of the attrition related to our conversion project occurred in this area.

The New England branch turned in a stellar performance. Following a good year in 2007, it managed to post improvements in every area, including gains in sales, recurring revenues and earnings. It also managed to end up with an increase in backlog, truly a special overall achievement in these times.

The New Jersey office had a respectable year, but had an uncharacteristic off year in new sales, resulting in a significant drop in backlog. This did not negatively affect the short term due to this branch's better than expected performance in controlling attrition. However, its continued success in 2009 and beyond will be dependent upon a rebound in new sales performance.

The Georgia branch had another solid year, albeit not quite as good as the prior year, which had the benefit of one multi-million dollar new sale. Still, this branch posted its highest ever earnings and an improved attrition rate.

The Florida office posted its second straight positive year highlighted by its highest earnings ever. It also managed to realize new sales near the prior year's level despite a dropoff of business in this region generated from the National Accounts Division.

The North Carolina branch continued to improve. Not only did it make further gains in profitability and new sales, but it managed to end the year with a 35% increased backlog, all but assuring continued success in 2009.

The Maryland office posted results consistent with those during the prior year. In April, 2008, to address a geographical void in our service, we opened a satellite office in Virginia. While this move has addressed our operational needs in the area, the additional associated costs coupled with recent months decrease in sales are challenging the economic performance of this branch.

Management will be constantly reviewing not only the Maryland Branch, but the entire Company's performance in light of the volatile economy. We intend to be proactive and not let any potential problems get out of hand. Fortunately, to this point, we have been able to avoid having to make any of the cutbacks that some prominent competitors in our industry have already endured. We believe the principal reason for our "better" situation is our customer mix, which is largely commercial. There is no doubt that during the past six months the residential market has been more severely affected than the commercial market by this economy.

We have also continued to be successful in controlling major expenses. During the year we were able to hold all of our insurance and medical costs at the prior year's levels.

The end result was that in the midst of all the surrounding corporate red ink, layoffs, benefit reductions and general anxiety, we were able to maintain our workforce, not suffer any other cutbacks or employee dissatisfaction, grow our customer base and continue to generate meaningful earnings.

As you know, largely because of the year we experienced, your Board of Directors authorized a special $20 per share dividend which was paid in the last quarter of 2008. Significantly, this special dividend was paid out of cash on hand, without the need for any further financing.

The first quarter of 2009 has been encouraging. The Company's attrition rate has come down and our recurring revenues continued to grow. Sales, while not robust, have been maintained at acceptable levels.

Predicting our future is never certain, particularly now in the face of the unprecedented economic crisis facing the nation. However, we maintain a strong enough backlog of work and a solid customer base, such that if the economy does turn around during 2009 the Company should weather the crisis quite well. In fact, we expect that we should remain above the storm in 2009 and continue to post successful operating results.

Robert D. Kleinman
Chairman and Chief Executive Officer

AFA Protective Systems, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31,	2008	2007
Assets		
Current assets		
Cash and cash equivalents	**$ 2,700,715**	$ 2,288,597
Accounts receivable, net of allowance for doubtful accounts of $150,000 and $170,000 in 2008 and 2007, respectively	**13,902,747**	14,305,777
Inventory, other than installation materials	**5,249,581**	5,276,117
Prepaid expenses and other current assets	**588,304**	251,273
Total current assets	**22,441,347**	22,121,764
Property, plant and equipment, net	**10,096,607**	10,967,918
Inventory of installation materials	**276,294**	219,838
Goodwill and intangible assets, net	**514,277**	549,414
Other assets	**157,011**	321,475
Total assets	**$33,485,536**	$34,180,409
Liabilities and Shareholders' Equity		
Current liabilities		
Current portion of long-term debt	**$ 1,628,446**	$ 1,615,068
Accounts payable	**3,553,720**	4,264,475
Accrued expenses and other current liabilities	**6,233,205**	4,759,237
Deferred revenues	**6,909,252**	6,058,159
Total current liabilities	**18,324,623**	16,696,939
Long-term debt	**4,187,294**	5,815,744
Deferred income taxes	**170,200**	383,500
Pension obligation	**124,650**	—
Obligation for postretirement benefits	**219,271**	244,627
Deferred revenues	**2,471,554**	2,519,443
Fair value of interest rate swaps	**472,208**	38,307
Total liabilities	**25,969,800**	25,698,560
Commitments and Contingencies (Note 16)		
Shareholders' equity		
Common stock, $1 par value; 1,500,000 shares authorized; 153,420 shares issued and outstanding in 2008 and 153,497 shares in 2007	**153,420**	153,497
Additional paid-in capital	**316,416**	316,565
Accumulated other comprehensive loss	**(802,144)**	(656,918)
Retained earnings	**7,848,044**	8,668,705
Total shareholders' equity	**7,515,736**	8,481,849
Total liabilities and shareholders' equity	**$33,485,536**	$34,180,409

The accompanying notes are an integral part of these consolidated financial statements.

AFA Protective Systems, Inc. and Subsidiaries

Consolidated Statements of Income and Comprehensive Income

Years Ended December 31,	2008	2007
Revenues		
Sales	**$52,683,340**	$48,465,616
Service	**29,123,167**	28,129,317
	81,806,507	76,594,933
Costs and expenses		
Cost of sales	**37,645,317**	35,460,986
Cost of services, exclusive of depreciation and amortization	**18,924,356**	18,329,098
Depreciation and amortization	**2,291,049**	2,441,980
Selling, general, and administrative	**17,896,486**	17,161,228
	76,757,208	73,393,292
Income from operations	**5,049,299**	3,201,641
Interest and dividend income	**173,495**	210,408
Interest expense, net	**(853,342)**	(762,592)
Income before provision for income taxes	**4,369,452**	2,649,457
Provision for income taxes	**1,792,000**	1,025,000
Net income	**$ 2,577,452**	$ 1,624,457
Earnings per share	**$ 16.80**	$ 10.57
Weighted average number of shares outstanding	**153,435**	153,617
Dividends per share	**$ 22.00**	$ 2.00
Comprehensive income		
Net income	**$ 2,577,452**	$ 1,624,457
Other comprehensive loss, net of tax		
Net actuarial loss arising during the year	**(145,226)**	(53,157)
Comprehensive income	**$ 2,432,226**	$ 1,571,300

The accompanying notes are an integral part of these consolidated financial statements.

AFA Protective Systems, Inc. and Subsidiaries

Consolidated Statements of Shareholders' Equity

Years Ended December 31, 2008 and 2007

	Number of Shares	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance at December 31, 2006	153,959	$153,959	$317,459	$(603,761)	$ 7,483,178	$ 7,350,835
Net income for the year	—	—	—	—	1,624,457	1,624,457
Cash dividends ($2.00 per share)	—	—	—	—	(307,231)	(307,231)
Net actuarial loss arising during the year	—	—	—	(53,157)	—	(53,157)
Purchase and retirement of common stock	(462)	(462)	(894)	—	(131,699)	(133,055)
Balance at December 31, 2007	153,497	153,497	316,565	(656,918)	8,668,705	8,481,849
Net income for the year	**—**	**—**	**—**	**—**	**2,577,452**	**2,577,452**
Cash dividends ($22.00 per share)	**—**	**—**	**—**	**—**	**(3,375,239)**	**(3,375,239)**
Actuarial loss, net of taxes	**—**	**—**	**—**	**(145,226)**	**—**	**(145,226)**
Purchase and retirement of common stock	**(77)**	**(77)**	**(149)**	**—**	**(22,874)**	**(23,100)**
Balance at December 31, 2008	**153,420**	**$153,420**	**$316,416**	**$(802,144)**	**$ 7,848,044**	**$ 7,515,736**

The accompanying notes are an integral part of these consolidated financial statements.

AFA Protective Systems, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31,	2008	2007
Cash flows from operating activities		
Net income	**$ 2,577,452**	$ 1,624,457
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**2,308,734**	2,459,665
Provision for doubtful accounts	**281,259**	237,021
Gain on insurance recovery from officers' life insurance	**—**	(28,342)
Deferred income taxes	**(118,400)**	(40,900)
Loss on interest rate swap	**433,901**	252,370
Net periodic pension costs	**105,315**	27,451
Changes in operating assets and liabilities		
Accounts receivable	**121,771**	(3,202,949)
Inventory, other than installation materials	**26,536**	(1,295,138)
Prepaid expenses and other current assets	**(337,031)**	147,753
Other assets	**15,166**	(18,752)
Accounts payable	**(710,755)**	953,344
Accrued expenses and other current liabilities	**1,176,849**	1,032,126
Deferred revenues	**803,204**	(283,348)
Liability for postretirement benefits	**182,582**	(53,898)
Net cash provided by operating activities	**6,866,583**	1,810,860
Cash flows from investing activities		
Capital expenditures	**(1,436,644)**	(1,904,214)
Acquisition of intangible assets	**(4,410)**	(21,414)
Insurance proceeds from officers' life insurance	**—**	651,697
Net cash used in investing activities	**(1,441,054)**	(1,273,931)
Cash flows from financing activities		
Dividends paid	**(3,375,239)**	(307,231)
Purchase and retirement of common stock	**(23,100)**	(133,055)
Repayments of mortgage note	**(215,068)**	(202,472)
Repayments of term loan	**(1,400,004)**	(1,400,004)
Net cash used in financing activities	**(5,013,411)**	(2,042,762)
Net increase (decrease) in cash and cash equivalents	**412,118**	(1,505,833)
Cash and cash equivalents		
Beginning	**2,288,597**	3,794,430
Ending	**$ 2,700,715**	$ 2,288,597
Supplemental disclosures of cash flow information		
Cash paid for:		
Interest	**$ 419,400**	$ 497,600
Income taxes	**2,075,490**	861,386

The accompanying notes are an integral part of these consolidated financial statements.

1. Organization and Basis of Presentation

Description of the Business

AFA Protective Systems, Inc. and Subsidiaries (the "Company") is engaged in the installation, operation, maintenance and sale of protective systems to safeguard life and property from a variety of hazards. Operations are conducted primarily in the eastern United States.

Basis of Presentation

The financial statements include the accounts of AFA Protective Systems, Inc. and its subsidiaries, all of which are wholly owned. All intercompany balances and transactions have been eliminated in consolidation.

2. Summary of Significant Accounting Policies

Revenue Recognition

Service charges to alarm system subscribers, for services to be rendered over a maximum period of one year, are deferred and taken into income as earned over the service period. Advance service billings on new subscribers are also deferred and reflected in income over a five-year period, the term of most contracts. For income tax purposes, the Company reports advance billings as income in the year billed. Selling expenses in connection with obtaining new subscribers are charged to income from operations as incurred.

The percentage-of-completion method is used for the recognition of revenue from sales of security systems under long-term contracts in accordance with AICPA Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," and is based on the ratio of costs incurred to date on the contract to total estimated contract costs, after providing currently for all known or anticipated losses. Due to uncertainties inherent in the estimation process, it is possible that completion costs will be revised in the near term. Such revisions to costs and income are recognized in the period in which the revisions are determined.

Fair Value of Financial Instruments

In assessing the fair value of financial instruments at December 31, 2008 and 2007, the Company has used a variety of methods and assumptions, which were based on estimates of market conditions and risks existing at the time. The fair value of financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate their carrying value because of the current nature of these instruments. The carrying value of the Company's long-term borrowings at December 31, 2008 and 2007 approximate fair value as interest rates approximate current market rates based on their variable nature. The Company believes its mortgage interest rate reflects current market rates. The Company's interest rate swaps have been measured at fair value under the principles of SFAS 157, "Fair Value Measurements," (Note 14).

Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with original maturities of 90 days or less. At December 31, 2008 and 2007, cash and cash equivalents included money market funds of $1,244,628 and $1,685,452, respectively. Cash and cash equivalents held at financial institutions may at times exceed federally insured amounts. The Company believes it mitigates its risks by investing in or through major financial institutions. Recoverability of investments is dependent upon the performance of the issuer.

Accounts Receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a regular basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Inventories

Inventory, other than installation materials, consists of finished goods, work in progress and parts related to the sale of security systems which are carried at the lower of cost (on a first-in, first-out basis) or market. Inventory of installation materials is classified as noncurrent.

The Company continues to evaluate the composition of its inventory and has determined that most inventory is used in the construction of protective systems in outright systems sales to customers. As a result, the Company now classifies only inventory to be used to construct Company-owned systems at subscriber premises as inventory of installation materials. This resulted in a reclassification at December 31, 2007 of inventory classified as noncurrent to inventory classified as current of $3,147,701. The Company continues to evaluate its inventories on a periodic basis for slow moving, excess and obsolete stock on hand.

Property, Plant and Equipment

Property, plant and equipment are recorded at their historical cost and depreciated over their estimated useful lives, which range from 10 to 30 years. Maintenance and repairs are charged to expense as incurred; renewals and improvements that extend the life of the asset are capitalized. Upon retirement or sale, the asset cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gains or loss, if any,

is included in the results of operations for the year. Leasehold improvements are amortized over the shorter of the lease term or remaining useful life of the related assets.

Central station equipment, equipment in subscribers' premises and other equipment are depreciated primarily by accelerated methods. The straight-line method is used for buildings and leasehold improvements. For income tax purposes, installation costs are deducted as incurred and accelerated methods and rates are used for all other assets.

Debt Issue Costs

Debt issue costs are being amortized using the interest method over the term of the related debt. Amortization of $17,684 has been recorded in interest expense in the consolidated statements of income and comprehensive income in each of the years ended December 31, 2008 and 2007, respectively.

Goodwill and Intangible Assets

The Company follows the provision of SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill and indefinite lived intangible assets are not amortized but instead are reviewed annually for impairment or more frequently if impairment indicators arise. The Company tests for impairment whenever events or changes in circumstances indicate that the carrying amount of goodwill or other intangible assets may not be recoverable or at least annually at December 31 of each year. In the event that the Company determines that the value of goodwill or other intangible assets have become impaired, the Company will incur a charge for the amount of the impairment during the fiscal period in which the determination is made. The Company completed its review and determined there was no impairment during the years ended December 31, 2008 and 2007 (Note 5). Identifiable intangible assets primarily represent alarm contracts arising from acquisitions and are amortized on a straight-line basis over their estimated useful lives ranging primarily from four to eight years.

Impairment of Long-Lived Assets

The Company applies the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. In reviewing for impairment, the Company compares the carrying value of the assets to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. When the estimated undiscounted future cash flows are less than their carrying amount, an impairment loss is recognized equal to the difference between the assets' fair value and its carrying amount. The Company believes the future cash flows to be received from its long-lived assets exceed the assets' carrying value, and accordingly, the Company has not recognized any impairment losses for the years ended December 31, 2008 and 2007.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, are primarily trade accounts receivable. Customers in the commercial real estate industry, principally commercial building properties, account for a substantial portion of trade receivables. Credit risk with respect to trade receivables is generally minimized due to the large corporations and other organizations the Company services. Accounts receivable due from a major customer amounted to approximately $2,613,000 and $2,706,000 at December 31, 2008 and 2007, respectively. Billings to this customer amounted to $24,757,000 and $19,041,000 for the years ended December 31, 2008 and 2007, respectively.

Advertising Costs

Costs for advertising are expensed when incurred. Advertising expense was approximately $279,000 and $260,000 for the years ended December 31, 2008 and 2007, respectively.

Earnings Per Share

Earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the reporting period. The Company has no dilutive securities.

Income Taxes

Deferred income taxes are provided for the tax effects of differences between the financial reporting and tax bases of the Company's assets and liabilities at the enacted tax rates in effect for the years in which the differences are expected to reverse. The Company evaluates the recoverability of deferred tax assets and establishes a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109. This interpretation prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. There was no cumulative effect as a result of adopting FIN 48. The Company recognizes interest expense and penalties related to unrecognized tax benefits within income tax expense.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include accounting for long-term contracts, the allowance for doubtful accounts, inventory obsolescence, depreciation and amortization, employee benefit plans, income taxes and contingencies.

Derivative Financial Instruments

The Company accounts for derivative instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133 requires that the Company recognize all derivatives as assets or liabilities and measure those instruments at fair value. The Company uses derivatives for the purpose of hedging exposure to changes of interest rates but does not qualify for hedge accounting under SFAS 133. Changes in the fair value of derivatives that do not qualify for hedge accounting are recorded immediately in the statement of income. The fair value of each derivative is recognized in the consolidated balance sheet within other assets and other liabilities (Notes 6 and 7). For the years ended December 31, 2008 and 2007, the Company recognized a loss of $433,901 and $252,370 on its interest rate swaps, respectively. Both changes resulted from changes in the fair value of the derivatives, which has been included as a component of interest expense in the consolidated statements of income and comprehensive income.

Recently Issued Accounting Pronouncement

In September 2006, The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. SFAS No. 157 applies to fair value measurements already required or permitted by existing standards and became effective for the Company as of December 31, 2008 (Note 14).

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, "Fair Value Option for Financial Assets and Liabilities." SFAS No. 159 provides an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements. The fair value option established by SFAS No. 159 permits the Company to elect to measure eligible items at fair value on an instrument-by-instrument basis and then report unrealized gains and losses for those items on the Company's earnings. SFAS No. 159 became effective for the Company on December 31, 2008. The Company has not elected to fair value any of its assets or liabilities in accordance with SFAS No. 159.

In March 2008, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 161, "Disclosure about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 is effective for fiscal years beginning after November 15, 2008. SFAS 161 requires enhanced disclosures about the Company's derivative and hedging activities, including how such activities are accounted for and their effect on the Company's financial position, performance and cash flows. Management is currently evaluating the impact the adoption of SFAS 161 will have on the Company's financial statements and related disclosures.

3. Accounts Receivable

Accounts receivable consist of the following:

December 31,	2008	2007
Trade receivables, including progress bills and amounts due on completed contracts	**$12,169,242**	$12,544,489
Costs and estimated earnings in excess of billings on uncompleted contracts	**1,883,505**	1,931,288
	14,052,747	14,475,777
Less: allowance for doubtful accounts	**(150,000)**	(170,000)
	$13,902,747	$14,305,777

Cost and estimated earnings on uncompleted contracts and related amounts billed were as follows:

December 31,	2008	2007
Costs incurred on uncompleted contracts	**$ 4,256,176**	$ 3,762,897
Estimated earnings	**1,322,508**	1,259,578
	5,578,684	5,022,475
Less: billings to date	**(4,109,475)**	(3,367,779)
	1,469,209	1,654,696
Costs and estimated earnings in excess of billings	**(1,883,505)**	(1,931,288)
Billings in excess of costs (included in accrued expenses and other current liabilities)	**$ (414,296)**	$ (276,592)

Costs and estimated earnings in excess of billings on uncompleted contracts arise in the consolidated balance sheets when revenues have been recognized but the amounts cannot be billed under the terms of the contracts. Such amounts are recoverable from customers based upon various measures of performance, including achievement of certain milestones or completion of the contract. Substantially all amounts recorded as costs and estimated earnings in excess of billings on uncompleted contracts at December 31, 2008, are expected to be billed and collected within one year.

4. Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following:

	Estimated Lives	December 31, 2008	2007
Land and buildings	30	**$ 4,921,235**	$ 4,921,235
Equipment in subscribers' premises	10-25	**44,657,392**	43,195,484
Central station and other equipment	10	**15,079,364**	14,762,630
Leasehold improvements	Lesser of lease term or useful life*	**380,120**	380,120
Installations in progress		**351,321**	749,772
		65,389,432	64,009,241
Less: accumulated depreciation		**(55,292,825)**	(53,041,323)
		$ 10,096,607	$ 10,967,918

*Depreciation expense is initiated once equipment is fully installed and operational.

Depreciation expense was $2,251,502 and $2,371,972 for the years ended December 31, 2008 and 2007, respectively.

5. Goodwill and Intangible Assets, Net

Goodwill and intangible assets, net consists of the following:

	Estimated Lives	December 31, 2008	2007
Goodwill	—	**$ 441,301**	$ 441,301
Alarm contracts	4-8 years	**263,381**	778,076
Non-compete and other agreements	5 years	**—**	16,535
Gross goodwill and intangibles		**704,682**	1,235,912
Less: accumulated amortization		**(190,405)**	(686,498)
Goodwill and intangible assets, net		**$ 514,277**	$ 549,414

Amortization of intangible assets was $39,547 and $70,008 during the years ended December 31, 2008 and 2007, respectively. Future estimated amortization expense for the next five years is as follows as of December 31, 2008:

Years Ending December 31,	
2009	$39,174
2010	27,212
2011	6,230
2012	360
	$72,976

6. Other Assets

Other assets consist of the following:

December 31,	2008	2007
Prepaid pension costs (Note 12)	**$ —**	$131,614
Debt issue costs, net (Note 2)	**84,304**	101,988
Other	**72,707**	87,873
	$157,011	$321,475

7. Long-Term Debt

Long-term debt consists of the following:

December 31,	2008	2007
Term loan	**$ 2,099,986**	$ 3,499,990
Mortgage note	**3,715,754**	3,930,822
	5,815,740	7,430,812
Less: current portion	**(1,628,446)**	(1,615,068)
Long-term debt	**$ 4,187,294**	$ 5,815,744

Future maturities of long-term debt are as follows:

Years Ending December 31,	
2009	$1,628,446
2010	942,248
2011	257,752
2012	273,786
2013	290,816
Thereafter	2,422,692
	$5,815,740

On June 1, 2005, the Company obtained a $7,000,000 five-year term loan from its primary bank collateralized by a blanket U.C.C. filing against its assets. Repayment is to be made in monthly principal installments of $116,667 with an interest rate of LIBOR (1.88% at December 31, 2008 and 4.4% at December 31, 2007) + 1.6%. The terms of the agreement contain various restrictive covenants which include, but are not limited to, maintenance of certain income to debt service ratios and certain adjusted earnings requirements, as defined. Subsequent to year end, the Company received a waiver for noncompliance with certain loan provisions.

On June 1, 2005, the Company obtained a $4,400,000 ten-year mortgage from its primary bank collateralized by three buildings owned by the Company whose carrying value at December 31, 2008 and 2007 was approximately $1,876,000 and $2,033,000, respectively. Repayment is to be made in equal monthly installments of $37,249 based on an amortization schedule of fifteen years with interest of LIBOR +1.52%. The remaining principal balance of $1,924,393 will be due in full on July 15, 2015.

In connection with the term and mortgage loans, the Company entered into two interest rate swap agreements (the "Swaps") with its primary bank to effectively fix its variable interest rates at 5.67% on the term loan and 6.05% on the mortgage loan. The fair value of the Swaps of $(472,208) and $(38,307) at December 31, 2008 and 2007, respectively, has been recorded based on current market rates.

The Company has available $3,600,000 in a line of credit with its primary bank collateralized by a blanket U.C.C. filing against its assets expiring June 6, 2010. Interest is payable at LIBOR plus 2.10%. Use of the funds are unrestricted. At December 31, 2008 and 2007, the Company had $3,600,000 of its line of credit available for use.

8. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

December 31,	2008	2007
Salaries, wages and vacation	**$2,838,613**	$3,085,551
Employee benefit plan contribution	**1,210,288**	1,019,982
Current portion of liability for postretirement benefits	**46,004**	48,207
Income taxes payable	**160,867**	234,866
Billings in excess of costs	**414,296**	276,592
Healthcare costs payable	**350,000**	—
Refundable NYC Fire Department fees	**1,079,658**	—
Other	**133,479**	94,039
	$6,233,205	$4,759,237

9. Deferred Revenues

Deferred revenues consist of annual service and other charges and advance service charges. Annual service and other charges represent customer billings for services not yet rendered for which the maximum billing period is one year and have been reflected as a current liability. Advance service charges consist of nonrefundable charges billed to customers at the time of new installations. The portion of these charges expected to be recognized within one year has been classified as current. An analysis of deferred revenues is as follows:

	Annual Service and Other Charges	Advance Service Charges	Total
Balance, December 31, 2006	$ 4,715,091	$ 4,145,859	$ 8,860,950
Billings	26,468,084	1,377,885	27,845,969
Amortizations to income	(26,507,316)	(1,622,001)	(28,129,317)
Balance, December 31, 2007	4,675,859	3,901,743	8,577,602
Billings	**28,378,433**	**1,547,938**	**29,926,371**
Amortizations to income	**(27,564,040)**	**(1,559,127)**	**(29,123,167)**
Balance, December 31, 2008	**$ 5,490,252**	**$ 3,890,554**	**$ 9,380,806**

10. Common Stock

Issuance of Employee Stock Appreciation Rights

The Company issued stock appreciation rights to certain employees in January 2007 which will be payable only upon sale of the Company or change in its control, as defined. Since the sale of the Company or change in its control, as defined, are contingent events, no compensation expense is recorded until such events are probable of occurrence.

Stock Repurchases

The Company purchased and retired 77 and 462 shares of common stock for $23,100 and $133,055 during the years ended December 31, 2008 and 2007, respectively. The shares issued and outstanding were 153,420 and 153,497 at December 31, 2008 and 2007, respectively.

11. Income Taxes

Components of the provision for income taxes are as follows:

December 31,	2008	2007
Current		
Federal	**$1,474,300**	$ 804,500
State and local	**436,100**	261,400
	1,910,400	1,065,900
Deferred		
Federal	**(99,300)**	(39,000)
State and local	**(19,100)**	(1,900)
	(118,400)	(40,900)
	$1,792,000	$1,025,000

A reconciliation of the federal statutory rate and the Company's effective tax rate follows:

	2008	2007
Federal statutory rate	**34.0%**	34.0%
State and local income taxes, net of federal income tax benefit	**7.0%**	6.7%
Other items	**0.0%**	(2.0)%
Effective rate	**41.0%**	38.7%

The effective tax rate differed from the federal statutory tax rate primarily as result of state income taxes and certain non-taxable income.

The tax effects of the significant temporary differences which comprise the deferred tax assets and liabilities at December 31 are as follows:

December 31,	2008	2007
Deferred Tax Assets		
Advance service revenue	**$ 1,650,600**	$ 1,610,900
Intangibles	**738,200**	949,800
Net operating loss carryforwards (state)	**5,300**	61,500
Benefit plans	**148,200**	64,100
Other	**329,700**	122,300
	2,872,000	2,808,600
Less: valuation allowance	**(5,300)**	(61,500)
Deferred tax assets	**2,866,700**	2,747,100
Deferred Tax Liabilities		
Depreciation	**(2,912,700)**	(3,011,300)
Other	**(124,200)**	(119,300)
Net deferred tax liabilities	**$ (170,200)**	$ (383,500)

As of December 31, 2008 and 2007, the Company recorded a valuation allowance of $5,300 and $61,500, respectively, on the deferred tax assets to reduce the total to an amount that management believes will ultimately be realized. Realization of deferred tax assets is dependent upon sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income. The net change in the valuation allowance against deferred tax assets were decreases of $56,200 and $28,000 during the years ended December 31, 2008 and 2007, respectively.

12. Retirement Benefits

The Company maintains a noncontributory defined benefit pension plan for its hourly union employees who meet certain requirements of age, length of service and hours worked per year. The benefits provided are based upon years of service and the employee's compensation during the last five years of employment. The Company's funding policy is to contribute annually at least the minimum amount required by Federal regulations. Effective October 15, 1996, the collective bargaining agreement covering the New York/New Jersey union employees was terminated following a strike, which resulted in a workforce reduction. Accordingly, the plan was amended effective December 31, 1996, to eliminate benefit accruals for the remaining New York/New Jersey employees. Effective January 1, 1997, the plan was further amended to provide those participants whose benefits were frozen due to the termination of the union agreement, to have their benefits determined using the method applicable for early retirement if they continue in service until then. In conjunction with the Company's collective bargaining agreement effective August 1,

2007 covering its Massachusetts union employees effective February 1, 2008, the plan was amended to eliminate benefit accruals for the Massachusetts employees, and new employees are no longer eligible to enter the plan.

The Company provides certain health care and life insurance benefits to retired employees who have attained age 62 or 20 years of service at the date of retirement, whichever is later. Eligible retirees under age 65 are covered by the Company's health insurance plan, at a cost to the retiree equal to the Company's cost for an active employee. After attaining age 65, an eligible retiree's health care benefit coverage becomes coordinated with Medicare, with the retiree paying a portion of the cost of the coverage in excess of certain amounts. Effective December 31, 1996, the Company eliminated future benefits for employees who had not already retired or had given notice of retirement at that date. The Company's funding policy is generally to pay covered expenses as they are incurred.

The following is a reconciliation of the benefit obligation, fair value of plan assets and funded status of the Company's defined benefit and other postretirement benefit plans measured at December 31, 2008 and 2007, respectively:

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	**2008**	2007
Change in Benefit Obligation				
Benefit obligation at beginning of year	**$5,121,408**	$4,997,383	**$ 292,834**	$ 306,763
Service cost	**2,817**	33,961	**—**	—
Interest cost	**325,843**	294,524	**17,878**	18,098
Actuarial loss	**268,205**	15,740	**6,404**	21,871
Benefits paid	**(216,577)**	(220,200)	**(51,841)**	(53,898)
Benefit obligation at end of year	**$5,501,696**	$5,121,408	**$ 265,275**	$ 292,834
Change in Plan Assets				
Fair value of plan assets at beginning of year	**$5,253,022**	$5,205,036	**$ —**	$ —
Actual return on plan assets	**229,775**	268,186	**—**	—
Employer contribution	**—**	—	**51,841**	53,898
Benefits paid	**(216,577)**	(220,200)	**(51,841)**	(53,898)
Fair value of plan assets at end of year	**$5,266,220**	$5,253,022	**$ —**	$ —
Net amount recognized	**$ (235,476)**	$ 131,614	**$(265,275)**	$(292,834)

Amounts recognized in the consolidated balance sheet consist of:

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	**2008**	2007
Prepaid pension cost	**$ —**	$131,614	**$ —**	$ —
Accrued pension liability ($110,826 in accrued liability in 2008)	**(235,476)**	—	**—**	—
Current portion of liability for postretirement benefits	**—**	—	**(46,004)**	(48,207)
Liability for postretirement benefits	**—**	—	**(219,271)**	(244,627)
Net amount recognized	**$(235,476)**	$131,614	**$(265,275)**	$(292,834)

Amounts recognized in accumulated other comprehensive loss consist of:

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	**2008**	2007
Actuarial loss	**$1,144,527**	$754,924	**$192,617**	$206,755
Prior service cost	**—**	9,012	**—**	—
Transition obligation	**—**	124,327	**—**	—
	$1,144,527	$888,263	**$192,617**	$206,755

The amounts shown above have been recognized in accumulated other comprehensive loss totaling $802,144, net of deferred income tax assets of $535,000 at December 31, 2008 and accumulated other comprehensive loss totaling $656,918, net of deferred income tax assets of $438,100 at December 31, 2007.

Amounts recorded in other comprehensive loss consist of:

	Pension Benefits			Other Postretirement Benefits		
	2008			2008		
	Before Tax Amount	Tax (Expense) or Benefit	Net of Tax Amount	Before Tax Amount	Tax (Expense) or Benefit	Net of Tax Amount
Net actuarial loss arising during the year	**$318,716**	**$127,500**	**$191,216**	**$ 6,404**	**$ 2,600**	**$ 3,804**
Less: amortization included in net periodic pension cost	**62,452**	**25,000**	**37,452**	**20,542**	**8,200**	**12,342**
Net change during the year	**$256,264**	**$102,500**	**$153,764**	**$(14,138)**	**$(5,600)**	**$ (8,538)**

Components of net periodic pension and other postretirement benefits cost:

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	**2008**	2007
Service cost	**$ 2,817**	$ 33,961	**$ —**	$ —
Interest cost	**325,843**	294,524	**17,878**	18,098
Expected return on plan assets	**(411,579)**	(407,595)	**—**	—
Amortization of prior service cost	**751**	37,951	**—**	—
Amortization of net transition obligation	**1,295**	15,541	**—**	—
Amortization of net losses	**60,406**	15,654	**20,542**	19,317
Curtailment	**131,293**	—	**—**	—
	$ 110,826	$ (9,964)	**$38,420**	$37,415

Amounts recorded in accumulated other comprehensive loss expected to be recognized as a component of net periodic pension cost in 2009 are as follows:

	Pension Benefits	Other Postretirement Benefits
Actuarial loss	$53,439	$16,609
Total	$53,439	$16,609

Weighted average assumptions used to determine the benefit obligation and net periodic pension and other postretirement benefits cost as of and for the years ended December 31:

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	**2008**	2007
Discount rate	**6.00%**	6.00%	**6.00%**	6.00%
Expected return on plan assets	**8.00%**	8.00%	**—**	—
Rate of compensation increase	**5.00%**	5.00%	**—**	—

The expected return on plan assets has been determined based on historical rates of return.

The assumed increase in health care cost trend rate at the end of 2008 was 8%, gradually decreasing to 4.5% by the year 2022 and is expected to remain at that level thereafter. A one percentage point increase or decrease in these trend rates would not have a significant effect on the accumulated benefit obligation at December 31, 2008 and the net periodic pension and other postretirement benefits cost for 2008.

Plan Assets

Assets are primarily invested in the General Account of Principal Mutual Life Insurance Company, which provides the contract and cashout value of the account. The General Investment Account is a low-risk fixed income investment, consistent with the defined benefit plan's strategy. The breakdown of the cashout value of the assets as of December 31, 2008 and 2007 is as follows:

	2008	2007
General Investment Account	**96.5%**	89.7%
Principal Financial Group Stock Separate Account	**3.5%**	10.3%

Cash Flows

The Company will contribute $110,826 to the Plan to meet minimum funding standards required under the Pension Protection Act of 2006.

Benefit payments, which reflect expected future service, as appropriate, expected to be paid for the next ten years are as follows:

Years Ending December 31,	Pension Benefits	Other Postretirement Benefits
2009	$ 319,171	$ 46,004
2010	338,449	39,483
2011	349,394	34,001
2012	366,109	29,361
2013	383,989	25,294
2014-2018	2,048,015	81,458
	$3,805,127	$255,601

In connection with the aforementioned curtailment of the defined benefit pension plan, effective December 1, 1996, the Company established a 401(k) savings plan covering all eligible employees. Under the plan, employees may contribute up to certain percentages of their pretax earnings, subject to the Internal Revenue Service annual contribution limit. The Company can make non-matching and matching contributions for all eligible employees who are not participants in the defined contribution pension plan discussed in the following paragraph. Company contributions to the plan amounted to approximately $277,000 and $279,400 for the years ended December 31, 2008 and 2007, respectively.

Substantially all non-union salaried employees of the Company are covered by another defined contribution pension plan. Contributions under the plan are based on specified percentages of the compensation of covered employees less forfeitures, if any. There is no unfunded past service cost for this plan. Pension expense for this plan was approximately $1,026,000 and $936,000 for the years ended December 31, 2008 and 2007, respectively.

13. Related Party Transactions

In 1968, the Company entered into an agreement with Ready Alarm, Inc. ("Ready") which provides for the sale to Ready of alarm systems installed prior to November 1, 1967 in the premises of a substantial portion of the Company's subscribers. In 1970, Ready was acquired by United Telephone Services, Inc. ("United"), all of the outstanding shares of which are owned by the Chairman of the Company, members of his family and family trusts. There have been no sales of alarm systems to Ready since its acquisition by United in 1970.

Pursuant to a United shareholders' agreement, all shares of the Company owned by United and present shareholders of United, which represent approximately 50% of the outstanding shares of the Company, are voted as directed by the Chairman.

The Company received approximately $139,000 and $140,000 in 2008 and 2007, respectively, for central station protection services rendered to Ready's subscribers under a contract expiring in June 2010.

A member of the board of directors is a shareholder in the insurance agency that the Company uses to place its insurance. Premiums incurred were approximately $1,362,000 and $1,225,000 in 2008 and 2007, respectively. The placement of insurance coverage and resulting premiums are subject to independent third party review.

14. Fair Value of Financial Instruments

In September 2006, the FASB Issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The Company adopted SFAS No. 157 effective for its fiscal year beginning January 1, 2008.

In December 2007, the FASB issued FASB Staff Position 157-2 "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. As such, the Company only partially adopted the provisions of SFAS 157 and will begin to account and report for non-financial assets and liabilities in 2009.

In October 2008, the FASB Staff Position 157-3, "Determining the Fair Value of Financial Assets When the Market for that Asset is Not Active" ("FSP 157-3"), to clarify the application of the provisions of SFAS 157 in an inactive market and how an entity would determine fair value in an inactive market. FSP 157-3 is effective immediately and has no impact on the amounts reported in the consolidated financial statements.

The primary effect of SFAS 157 on the Company was to expand the required disclosures pertaining to the methods used to determine fair value. SFAS 157 established a fair value hierarchy that prioritizes the inputs of valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS 157 are as follows:

Level 1—Unadjusted quoted prices in active markets that are accessible at the measurement dates for identical, unrestricted assets or liabilities.

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

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

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and counterparty creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realized value or reflective of future values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimate of fair value at the reporting date.

Cash equivalents consisting of money market funds are reported at fair value utilizing Level 1 Inputs. Derivatives are reported at fair value utilizing Level 2 Inputs. The Company obtained dealer quotations to assist it in the valuation of its interest rate swaps.

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Cash equivalents	$1,244,628	$ —	$ —	$1,244,628
Derivative liabilities	$ —	$472,208	$ —	$ 472,208

15. New York City Fire Department Litigation

In June 2008, the Company reached a settlement in an ongoing action against the New York City Fire Department. All disputed fees had been paid into an independent escrow fund pending resolution of the matter. The Company received approximately $3,860,000 of which approximately $2,559,000 was retained by the Company as a reimbursement of costs incurred since 1994, with the balance of approximately $1,301,000 to be returned to the Company's customers in the form of credits against future Fire Department fees.

16. Commitments and Contingencies

Leases

The Company is obligated under the terms of noncancellable operating leases for office, storage and operating facilities (real property) through 2013 for approximate aggregate minimum rentals of $2,101,000 as follows:

Years Ending December 31,	
2009	$ 897,000
2010	670,000
2011	385,000
2012	113,000
2013	36,000
	$2,101,000

Certain leases are renewable and substantially all leases provide for payment of various cost escalations. Rent expense for all operating leases, including motor vehicles, was approximately $2,434,000 and $2,283,000 for the years ended December 31, 2008 and 2007, respectively.

Other

Various claims incident to the ordinary course of business, some of which have resulted in litigation, are pending against the Company. In the opinion of management, disposition of these matters will not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

17. Life Insurance Policies

In February of 2007, the Company was reimbursed $651,697 representing the aggregate payments made on the life insurance policies for its current Chairman and current President. The cash surrender value of the policies at the time the proceeds were received was $623,355, resulting in a gain of $28,342. The Company recorded this gain as a reduction of insurance expense and accordingly, is reflected as a component of selling, general and administrative expenses in the consolidated statement of income and comprehensive income for the year ended December 31, 2007.

Report of Independent Auditors

To the Board of Directors and Shareholders of
AFA Protective Systems, Inc:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and comprehensive income, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of AFA Protective Systems, Inc. and its subsidiaries (the "Company") at December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

March 31, 2009
Melville, New York

AFA Protective Systems, Inc. and Subsidiaries

SELECTED FINANCIAL DATA

For Each of the Five Years in the Period Ended December 31, 2008

	2008	2007	2006	2005	2004
Sales	**$52,683,340**	$48,465,616	$40,189,627	$38,978,172	$34,669,296
Service revenues	**$29,123,167**	$28,129,317	$26,966,472	$26,342,278	$25,919,032
Net income	**$ 2,577,452**	$ 1,624,457	$ 893,906	$ 249,850(a)	$ 2,519,396
Earnings per share	**$ 16.80**	$ 10.57	$ 5.81	$ 1.62(a)	$ 16.33
Cash dividends per share	**$ 22.00**(c)	$ 2.00	$ 2.00	$ 62.00(b)	$ 2.00
Average number of shares outstanding	**153,435**	153,617	153,959	153,959	154,311
At year end:					
Deferred revenues	**$ 9,380,806**	$ 8,577,602	$ 8,860,950	$ 9,264,119	$ 9,660,494
Property, plant and equipment, net	**$10,096,607**	$10,967,918	$11,558,288	$12,072,500	$12,346,566
Total assets	**$33,485,536**	$34,180,409	$33,001,671	$34,915,384	$34,421,456
Shareholders' equity	**$ 7,515,736**(c)	$ 8,481,849	$ 7,350,835	$ 7,368,068(b)	$16,664,214
Number of shares outstanding	**153,420**	153,497	153,959	153,959	153,959
Book value per share	**$ 48.99**	$ 55.26	$ 47.75	$ 47.86	$ 108.24

(a) Net income and earnings per share in 2005 were adversely affected by $1,521,000 and $9.88, respectively, representing the purchase and retirement of 6,800 Stock Appreciation Rights.
(b) The Board of Directors approved a special dividend of $60 per share to shareholders of record on April 22, 2005 and paid on June 8, 2005.
(c) The Board of Directors approved a special dividend of $20 per share to shareholders of record on September 15, 2008 and paid on October 15, 2008.

AFA Protective Systems, Inc. and Subsidiaries

MARKET PRICES AND DIVIDEND INFORMATION

The Company's Common Stock is traded in the over-the-counter market. The range of high and low bid quotations as provided by the National Association of Security Dealers qualified interdealer quotation medium and the amount of cash dividends paid per share for each of the quarters of the fiscal years ended December 31, 2008 and 2007 are as follows:

Year Ended December 31, 2008

Quarter		Bid	Dividends
1	High	**$301**	**$ .50**
	Low	**300**	
2	High	**305**	**.50**
	Low	**300**	
3	High	**302**	**.50**
	Low	**300**	
4	High	**302**	**20.50**
	Low	**300**	
			$22.00

Year Ended December 31, 2007

Quarter		Bid	Dividends
1	High	$290	$ .50
	Low	285	
2	High	290	.50
	Low	285	
3	High	295	.50
	Low	288	
4	High	300	.50
	Low	295	
			$2.00

Corporate Information

Board of Directors

Asher Bernstein
President, Bernstein Management Corp., New York, NY

Stephen Hess*
President, Hess Associates, Manhasset, NY

Stephen Genatt*
President, Genatt Associates, New Hyde Park, NY

Michael Greene
Managing Director, Neuberger Berman, LLC New York, NY

Richard D. Kleinman
President, AFA Protective Systems, Inc.

Robert D. Kleinman
Chairman, Chief Executive Officer and General Counsel, AFA Protective Systems, Inc.

Fredric Mack
Partner, The Mack Company, Fort Lee, NJ

**Members of Audit Committee*

Officers

Robert D. Kleinman
Chairman, Chief Executive Officer and General Counsel

Richard D. Kleinman
President and Chief Operating Officer

James J. Jackson
Senior Vice President, Branch Operations

Raymond S. Greenberger
Vice President, Chief Financial Officer, Treasurer and Assistant Secretary

Stephen P. Hyle
Vice President and Director of National Accounts

David M. Kleinman
Secretary and In-House Counsel

Registrar and Transfer Agent

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016

Independent Auditors

PricewaterhouseCoopers LLP
401 Broad Hollow Road
Melville, NY 11747

Annual Meeting

The Annual Meeting of Stockholders will be held on Tuesday, June 2 at 11:30 a.m. at the Company's Corporate Headquarters, 155 Michael Drive, Syosset, New York. All stockholders are invited to attend. A formal Notice of Meeting accompanies this report.

Executive Offices

155 Michael Drive
Syosset, NY 11791
(516) 496-2322

Regional Offices

Florida
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