

NINETOWNS INTERNET TECHNOLOGY GROUP CO LTD  
Form 20-F/A  
July 16, 2008

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

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FORM 20-F/A

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2007

OR

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

OR

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

Date of event requiring this shell company report . . . . .

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

Commission file number \_\_\_\_\_

Ninetowns Internet Technology Group Company Limited  
(Exact name of Registrant as specified in its charter)

Cayman Islands  
(Jurisdiction of incorporation or organization)

22nd Floor, Building No.1,  
Capital A Partners, No.20 Gong Ti East Road,  
Chaoyang District Beijing 100020,  
The People's Republic of China  
(Address of principal executive offices)

Contact Person: Tommy Siu Lun Fork  
Chief Financial Officer  
Phone: +852-9021-9597  
Facsimile: +852-2868-4483

Address: 22nd Floor, Building No. 1, Capital A Partners,  
No.20 Gong Ti East Road, Chaoyang District Beijing 100020, China  
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
35,791,834 ordinary shares	Nasdaq Global Market

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None  
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

American Depositary  
Shares,  
each representing one  
ordinary share, par  
value HK\$0.025 per  
share  
(Title of Class)

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

35,791,834 ordinary shares, par value HK\$0.025 per

share

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
 Yes  No

Note -- Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
 Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this

filing:

U.S. GAAP  International Financial Reporting Standards as issued  Other

by the International Accounting Standards Board

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes  No



EXPLANATORY NOTE

This Amendment No. 1 on Form 20-F/A, or Amendment No. 1, amends our annual report on Form 20-F for the year ended December 31, 2007, which was filed with the Securities and Exchange Commission on July 15, 2008. This Amendment No. 1 is being filed to correct certain clerical errors appearing in our 20-F.

Except as described above and reflected in this Amendment No.1, no part of the Registrant's 20-F filed on July 15, 2008 is being amended, and no part of the Form 20-F/A as re-filed in this Amendment No.1 reflects any event occurring after the filing of the Form 20-F and should not be viewed as updating any information contained therein.

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Item 18. Financial Statements.

The consolidated financial statements for our company are included at the end of this annual report.

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Exhibit Number	Description
12.1	Certification of Chief Executive Officer pursuant to SEC Rule 13a-14(a)
12.2	Certification of Chief Financial Officer pursuant to SEC Rule 13a-14(a)
13.1	Certification of Chief Executive Officer pursuant to SEC Rule 13a-14(b)
13.2	Certification of Chief Financial Officer pursuant to SEC Rule 13a-14(b)
15.1	Consent of Deloitte Touche Tohmatsu CPA Ltd.

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Signatures

The registrant hereby certifies that it meets all of the requirements for filing its annual report on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this annual report on its behalf on this 16th day of July, 2008.

NINETOWNS INTERNET TECHNOLOGY GROUP  
COMPANY LIMITED

By: /s/ Shuang Wang  
Name: Shuang Wang  
Title: Chief Executive Officer

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To: The Board of Directors and Shareholders of  
Ninetowns Internet Technology Group Company Limited

We have audited the accompanying consolidated balance sheets of Ninetowns Internet Technology Group Company Limited, its subsidiaries and variable interest entities (collectively, the "Company") as of December 31, 2006 and 2007, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007, and related financial statement schedule included in Schedule I. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2006 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects, the information set forth therein.

As described in Note 2 to the consolidated financial statements, (1) effective on January 1, 2007, the Company adopted the recognition and measurement methods under Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109"; (2) effective on January 1, 2006, the Company changed its method of accounting for stock-based compensation to conform to Statement of Financial Accounting Standard No. 123 (revised 2004), "Share-Based Payment".

Our audits also comprehended the translation of Renminbi amounts into United States dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 2. Such United States dollar amounts are presented solely for the convenience of the readers.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 10, 2008 expressed an adverse opinion on the Company's internal control over financial reporting because of two material weaknesses.

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Deloitte Touche Tohmatsu CPA Ltd.  
Beijing, the People's Republic of China  
July 10, 2008

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## NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

CONSOLIDATED BALANCE SHEETS  
(In thousands, except share and per share data)

	Years Ended December 31,		
	2006 RMB	2007 RMB	2007 US\$
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalent	598,648	649,863	89,088
Restricted cash	-	853	117
Short-term investments:			
Available-for-sale securities	-	10,962	1,503
Term deposits	307,209	26,000	3,564
Trade receivables from customers			
Billed, less allowance for doubtful accounts of RMB1,088 in 2006 and RMB2,412 in 2007, respectively	17,943	30,222	4,143
Unbilled, less allowance for doubtful accounts of RMB Nil and RMB Nil for 2006 and 2007, respectively	832	874	120
Trade receivables from related parties			
Billed, less allowance for doubtful accounts RMB Nil and RMB20,887 in 2006 and 2007, respectively	28,330	6,350	871
Inventories	6,820	7,011	961
Prepaid expenses and other current assets	27,653	17,059	2,339
Deferred tax assets	1,698	1,300	178
Total current assets	989,133	750,494	102,884
Property and equipment, net			
Deposits for acquisition of property and equipment	73,411	34,804	4,771
Investment in an affiliate	-	2,450	336
Investments under cost method	38,929	40,786	5,591
Acquired intangible assets, net	22,697	73,851	10,124
Other non-current asset	856	937	128
Goodwill	193,570	78,081	10,705
<b>TOTAL ASSETS</b>	<b>1,365,289</b>	<b>1,171,180</b>	<b>160,555</b>

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	Years Ended December 31,		
	2006 RMB	2007 RMB	2007 US\$
<b>LIABILITIES MINORITY INTERESTS AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Accounts payable and accrued expenses	14,312	19,260	2,640
Amount due to an affiliate	-	1,450	199
Advance from customers	10,321	14,461	1,982
Deferred revenue	26,383	32,472	4,452
Income taxes payable	6,334	6,520	894
Other taxes payable	2,332	1,588	218
Unrecognized tax benefits	-	832	114
<b>Total current liabilities</b>	<b>59,682</b>	<b>76,583</b>	<b>10,499</b>
<b>Non-current liabilities</b>			
Deferred tax liabilities	627	16,210	2,222
<b>Total liabilities</b>	<b>60,309</b>	<b>92,793</b>	<b>12,721</b>
Minority interests	-	5,483	752
<b>Commitments (Note 17)</b>			
<b>Shareholders' equity:</b>			
Ordinary shares, par value RMB 0.027(HK\$ 0.025) per share: 8,000,000,000 shares authorized; 34,991,834 shares issued and outstanding in 2006 and 2007	926	926	127
Additional paid-in capital	871,642	873,568	119,755
Treasury shares, at cost, 47,862 shares and nil share in 2006 and 2007, respectively	(1,268)	-	-
Retained earnings	394,056	145,345	19,925
Statutory reserve	47,287	64,831	8,888
Accumulated other comprehensive loss	(7,663)	(11,766)	(1,613)
<b>Total shareholders' equity</b>	<b>1,304,980</b>	<b>1,072,904</b>	<b>147,082</b>
<b>TOTAL LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY</b>	<b>1,365,289</b>	<b>1,171,180</b>	<b>160,555</b>

See notes to consolidated financial statements.

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except share and per share data)

	Years Ended December 31,			
	2005 RMB	2006 RMB	2007 RMB	2007 US\$
<b>Net revenues:</b>				
Enterprise software and related customer maintenance services				
external customers	142,534	92,127	67,822	9,298
related parties (Note 15)	60,954	24,706	9,505	1,303
<b>Software development services</b>				
external customers	7,600	23,084	25,642	3,515
related parties (Note 15)	28,100	12,933	-	-
Computer hardware sales	678	398	-	-
Business-to-business search services	-	-	489	67
<b>Total net revenues</b>	<b>239,866</b>	<b>153,248</b>	<b>103,458</b>	<b>14,183</b>
<b>Cost of revenues:</b>				
Enterprise software and related customer maintenance services	(495)	-	-	-
Software development services (including share-based compensation expense of nil in 2005, RMB1,039 in 2006 and RMB126 in 2007)	(18,192)	(16,805)	(17,748)	(2,433)
Computer hardware sales	(482)	(134)	-	-
Business-to-business search services	-	-	(5,109)	(700)
<b>Total cost of revenues</b>	<b>(19,169)</b>	<b>(16,939)</b>	<b>(22,857)</b>	<b>(3,133)</b>
<b>Gross profit</b>	<b>220,697</b>	<b>136,309</b>	<b>80,601</b>	<b>11,050</b>
<b>Operating expenses:</b>				
Selling and marketing (including share-based compensation expense of nil in 2005, RMB3,371 in 2006, and RMB628 in 2007)	(25,752)	(13,604)	(41,086)	(5,633)
General and administrative (including share-based compensation expense of nil in 2005, RMB4,074 in 2006, and RMB1,145 in 2007)	(48,778)	(67,449)	(86,334)	(11,835)
Research and development (including share-based compensation expense of nil in 2005, RMB1,843 in 2006, and RMB27 in 2007)	(11,249)	(29,825)	(32,003)	(4,387)
(Allowance) recovery for doubtful accounts	(760)	1,521	(22,395)	(3,070)
Provision for impairment of goodwill	-	-	(193,570)	(26,536)
<b>Total operating expenses</b>	<b>(86,539)</b>	<b>(109,357)</b>	<b>(375,388)</b>	<b>(51,461)</b>
Government subsidies	447	705	1,015	139
<b>Income (loss) from operations</b>	<b>134,605</b>	<b>27,657</b>	<b>(293,772)</b>	<b>(40,272)</b>
Interest income	17,625	19,302	13,885	1,903
Gain from sales of short-term investments	-	-	43,546	5,970
<b>Income (loss) before provision for income taxes and minority interest</b>	<b>152,230</b>	<b>46,959</b>	<b>(236,341)</b>	<b>(32,399)</b>
Provision for income taxes	(626)	(1,031)	(243)	(33)

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Net income (loss) before minority interest	151,604	45,928	(236,584)	(32,432)
Minority interests in loss of subsidiary	-	-	6,053	830
Net income (loss)	151,604	45,928	(230,531)	(31,602)
Net income (loss) per share:				
Basic	4.39	1.32	(6.59)	(0.90)

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Diluted	4.25	1.30	(6.59)	(0.90)
Weighted average shares used in computation:				
Basic	34,539,976	34,773,005	34,966,830	34,966,830
Diluted	35,706,894	35,368,882	34,966,830	34,966,830

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
AND COMPREHENSIVE INCOME (LOSS)  
(In thousands, except share and per share data)

	Ordinary Shares	Ordinary Shares	Additional	Treasury	Shares	Retained	Statutory	Accumulated	
	Shares	Amount	Paid-in	Shares	Amount	Earnings	Reserve	Other	
		RMB	Capital		RMB	RMB	RMB	Compre-hensive	
			RMB					(Loss)	
								Income	
								RMB	
Balance as of January 1, 2005	34,391,834	911	845,730	-	-	200,531	43,280	-	1,090
Ordinary shares converted to ADR shares for future exercises of share options	600,000	15	15,585	(600,000)	(15,600)	-	-	-	
Issuance of ADR shares for the exercises of employee share options	-	-	-	284,774	7,404	-	-	-	7
Provision for statutory reserve	-	-	-	-	-	(4,007)	4,007	-	
Net income	-	-	-	-	-	151,604	-	-	151
Foreign currency translation adjustments	-	-	-	-	-	-	-	(3,095)	(3)
Balance as of December 31, 2005	34,991,834	926	861,315	(315,226)	(8,196)	348,128	47,287	(3,095)	1,246
Issuance of ADR shares for the exercises of employee share options	-	-	-	267,364	6,928	-	-	-	6
	-	-	10,327	-	-	-	-	-	10

Employee share options compensation										
Net income	-	-	-	-	-	45,928	-	-	-	45,928
Foreign currency translation adjustments	-	-	-	-	-	-	-	-	(4,568)	(4,568)
Balance as of December 31, 2006	34,991,834	926	871,642	(47,862)	(1,268)	394,056	47,287	(7,663)	1,304,000	1,304,000
Cumulative effect of unrecognized tax benefit on adoption of FIN 48	-	-	-	-	-	(636)	-	-	-	-
Issuance of ADR shares for the exercises of employee share options	-	-	-	47,862	1,268	-	-	-	-	1,304,000
Provision for statutory reserve	-	-	-	-	-	(17,544)	17,544	-	-	1,304,000
Net loss	-	-	-	-	-	(230,531)	-	-	-	(230,531)
Foreign currency translation adjustments	-	-	-	-	-	-	-	-	(6,977)	(6,977)
Employee share options compensation	-	-	1,926	-	-	-	-	-	-	1,926
Unrealized gain on available for sale securities	-	-	-	-	-	-	-	-	2,874	2,874
Balance as of December 31, 2007	34,991,834	926	873,568	-	-	145,345	64,831	(11,766)	1,072,000	1,072,000
		US\$127	US\$119,755	US\$-	US\$-	US\$19,925	US\$8,888	(US\$1,613)	US\$147,000	US\$147,000

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## NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands, except share and per share data)

	Years Ended December 31,			
	2005 RMB	2006 RMB	2007 RMB	2007 US\$
<b>Cash flows from operating activities:</b>				
Net income (loss)	151,604	45,928	(230,531)	(31,602)
Adjustments to reconcile net income to net cash provided by operating activities:				
Loss on disposal of property and equipment	263	511	1,544	212
Depreciation of property and equipment	2,877	6,194	9,867	1,353
Amortization of acquired intangible assets	2,416	2,943	14,466	1,983
Gain from sale of trading securities	-	-	(43,204)	(5,923)
Gain from sale of available for sale securities	-	-	(342)	(47)
Allowance (recovery) for doubtful debts	760	(1,521)	22,395	3,070
Provisions for goodwill impairment	-	-	193,570	26,536
Proceeds from sales of trading securities	-	-	94,834	13,001
Purchase of trading securities	-	-	(51,630)	(7,078)
Minority interest in loss of subsidiary	-	-	(6,053)	(830)
Employee share-based compensation	-	10,327	1,926	264
<b>Changes in operating assets and liabilities:</b>				
Inventories	401	903	(191)	(26)
Trade receivables from customers	(2,843)	2,854	(15,312)	(2,099)
Trade receivables from related parties	1,188	27,311	2,577	353
Prepaid expenses and other assets	16,668	(12,313)	11,986	1,643
Accounts payable and accrued expenses	(7,022)	164	(17,518)	(2,402)
Advance from customers	10,639	(318)	4,140	567
Deferred revenue	(29,344)	(41,503)	6,089	835
Deferred taxes, net	-	(1,071)	(1,125)	(154)
Income taxes payable	(77)	947	315	43
Other taxes payables	(1,158)	(524)	(744)	(102)
<b>Net cash provided by (used in) operating activities</b>	<b>146,372</b>	<b>40,832</b>	<b>(2,941)</b>	<b>(403)</b>
<b>Cash flows from investing activities:</b>				
Increase in restricted cash	-	-	(853)	(117)
Decrease (Increase) of term deposits	(56,087)	(100,209)	281,209	38,550
Cash paid for investments under cost method	-	(38,929)	(4,500)	(617)
Cash paid for establishment of an affiliate	-	-	(2,450)	(336)

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Purchases of available-for-sale securities			(10,076)	(1,381)
Proceeds from sales of available-for-sale securities	-	-	2,330	319
Purchase of property and equipment	(31,376)	(19,774)	(71,782)	(9,840)
Purchase of intangible assets for internal use	-	(17,200)	-	-
Payment for acquisition of property and equipment	(23,388)	(371)	(34,804)	(4,771)
Acquisition of a business, net of cash acquired of RMB 3,119	-	-	(101,881)	(13,967)
Net cash (used in) provided by investing activities	(110,851)	(176,483)	57,193	7,840
Cash flows from financing activities:				
Exercise of share options	7,404	6,928	1,268	174
Return of capital to minority shareholder upon dissolution of a subsidiary	-	(600)	-	-
Decrease in amounts due to shareholders	(5,360)	-	-	-
Net cash provided by financing activities	2,044	6,328	1,268	174
Effect of exchange rate changes	(3,084)	(3,503)	(4,305)	(590)
Net increase (decrease) in cash and cash equivalents	34,481	(132,826)	51,215	7,021
Cash and cash equivalents at the beginning of the year	696,993	731,474	598,648	82,067
				-

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Cash and cash equivalents at the end of the year	731,474	598,648	649,863	89,088
Supplemental non-cash investing activities:				
Amount payable for purchase of property and equipment			3,258	477
Supplemental cash flow information:				
Cash paid during the year for income taxes	703	1,156	909	125

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 FOR THE YEARS ENDED DECEMBER 31, 2005, 2006 AND 2007  
 (In thousands, except share and share-related data)

## 1. ORGANIZATION AND PRINCIPAL ACTIVITIES

Ninetowns Internet Technology Group Company Limited ("Ninetowns") was incorporated as an exempted limited liability company in the Cayman Islands on February 8, 2002 under the Companies Law of the Cayman Islands. At the time of its incorporation, all of the outstanding ordinary shares of Ninetowns were held by Jitter Bug Holdings Limited ("Jitter Bug"). Substantially all of Ninetown's business is conducted in the People's Republic of China (the "PRC") through its subsidiaries and variable interest entities ("VIE"). Ninetowns, its subsidiaries, and its "VIEs" (collectively, the "Company") are principally engaged in the sale of enterprise software and provision of the related after-sales maintenance services, software development services and in April 2007, the Company acquired a 70% equity interest in a Business to Business ("B2B") search engine operator (see note 3) and started to be engaged in the provision of B2B search services.

As of December 31, 2007, a summary of the subsidiaries and VIEs of Ninetowns was as follows:

Name of entity	Place of Incorporation/ Establishment	Effective ownership interest	Principal activities
Subsidiaries:			
Ixworth Enterprises Limited ("Ixworth")	British Virgin Islands ("BVI")	100%	Investment holding
Asia Pacific Logistics Limited ("Asia Pacific")	BVI	100%	Investment holding
Better Chance International Limited ("Better Chance")	BVI	100%	Investment holding
Beprecise Investments Limited ("Beprecise")	BVI	100%	Investment holding
Ample Spring Holdings Limited ("Ample Spring")	BVI	70%	Investment holding
New Take Limited	Hong Kong	100%	Investment holding
Shielder Limited	Hong Kong	100%	Investment holding
Beijing New Take Electronic Commerce Limited ("Beijing New Take")	PRC	100%	Inactive
Beijing Ninetowns Times Electronic Commerce	PRC	100%	Provision of software development services

Limited ("Beijing  
Ninetowns Times")

Beijing Ninetowns Digital Technology Limited ("Beijing Ninetowns Digital Technology")	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services
Beijing Ninetowns Ports Software and Technology Co., Ltd ("Beijing Ninetowns Ports")	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services
Beijing Ninetowns Network and Software Co., Limited ("Beijing Ninetowns Network")	PRC	100%	Sale of enterprise software and provision of the related after-sales services, and provision of technique consulting services
Guangdong Ninetowns Technology Co., Ltd. ("Guangdong Ninetowns")	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 FOR THE YEARS ENDED DECEMBER 31, 2005, 2006 AND 2007  
 (In thousands, except share and share-related data)

## 1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

Name of entity	Place of Incorporation/ Establishment	Effective ownership interest	Principal activities
Shanghai New Take Digital Technology Limited ("Shanghai New Take")	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services
Variable interest entities:			
Beijing Ronghe Tongshang Network Technology Limited ("Ronghe Tongshang")	PRC	100%	Provision of online solution for international trade
Beijing Baichuan Tongda Science and Technology Development Co., Ltd. ("Baichuan Tongda")	PRC	70%	Provision of Internet content services in the areas of B2B

PRC regulations prohibit direct foreign ownership of business entities providing internet content, or ICP, services in the PRC such as the business of providing online solution for international trade. In December 2006, Ronghe Tongshang was established in the PRC by three designated equity owners who are PRC citizens and legally own Ronghe Tongshang. Pursuant to a series of contractual arrangements with Ronghe Tongshang, the Company provides exclusive technical consulting and management services to Ronghe Tongshang. A summary of the major terms of the agreements are as follows:

1 The Company has the sole discretion to determine the amount of the fees it will receive and it intends to transfer substantially all of the economic benefits of Ronghe Tongshang to the Company;

1 The equity owners irrevocably granted the Company the right to make all operating and business decisions for Ronghe Tongshang on behalf of the equity owners;

1 All registered capital owned by the three equity owners were pledged to the Company as a collateral against the service fee payable to the Company;

1 The Company provides guarantees on the execution of all business contracts entered by Ronghe Tongshang in its business operation. Ronghe Tongshang pledges its assets to the Company as a collateral for such guarantee. Through December 31, 2007, Ronghe Tongshang has not yet entered into any business contracts that would require guarantees from the Ninetowns;

1 The Company may dispose of the collateralized registered capital at its sole discretion without limitation or restriction. The Company has the right and sole discretion to purchase all or part of the registered capital from equity owners when such purchase becomes legally allowable;



The equity owners may not dispose of or enter into any other agreements involving the common shares without prior agreement by the Company.

Because the above arrangement, which assigned all of the equity owners' rights and obligations to the Company resulting in the equity owners lacking the ability to make decisions that have a significant effect on Ronghe Tongshang's operations and the Company's ability to extract the profits from the operation of Ronghe Tongshang, and assume the Ronghe Tongshang's residual benefits. Because the Company is the sole variable interest holder of Ronghe Tongshang, it is the primary beneficiary of Ronghe Tongshang. Consistent with the provision of Financial Accounting Standards Board ("FASB") Interpretation No. 46 (Revised), "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51" ("FIN 46R"), the Company consolidates Ronghe Tongshang from its inception.

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## 1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

Baichuan Tongda is a PRC company which was established on February 24, 2004 for providing internet content services in the areas of B2B services. The founders of Baichuan Tongda were two PRC citizens ("original shareholders"). In April 2007, as part of the acquisition transaction of Ample Spring and Baichuan Tongda (described in Note 3), two designated PRC citizens ("70% registered shareholders") acquired 70% of the registered capital from the original shareholders. Pursuant to a series of contractual arrangements with Baichuan Tongda and the 70% registered shareholders, the Company bears the risk of, and enjoys the reward from the ownership of Baichuan Tongda. A summary of the major terms of the arrangements is as follows:

- lThe 70% registered shareholders irrevocably granted the Company the right to make all operating and business decisions for Baichuan Tongda on behalf of the 70% registered shareholders;
- lAll registered capital owned by the 70% registered shareholders is pledged to the Company as a collateral against the service fee payable to the Company;
- lThe Company may dispose of the collateralized registered capital at its sole discretion without limitation or restriction. The Company has the right and sole discretion to purchase all or part of the registered capital from the 70% registered shareholders when such purchase becomes legally allowable;
- lThe 70% registered shareholders may not dispose of or enter into any other agreements involving the shares owned by them without prior agreement by the Company;
- lThe Company is engaged by Baichuan Tongda as the exclusive service provider for business and technical support services and is entitled to a fee for the serviced provided;
- lThe Company has made an entrustment loan to Baichuan Tongda in the amount of RMB30,000 to finance the operations of Baichuan Tongda.

Through the above arrangements, the Company is the primary beneficiary of Baichuan Tongda. Accordingly, under the requirement of FIN46(R), Baichuan Tongda has become a variable interest entity of the Company and the financial statements of Baichuan Tongda have been consolidated by the Company since the designated 70% registered shareholders acquired the 70% equity interests from the original shareholders.

The following financial information of the above two VIEs was included in the accompanying consolidated financial statements.

	December 31,	
	2006	2007
	RMB	RMB
Total assets	396	27,752
Total liabilities	(1,000)	(51,325)

	Years Ended December 31, 2007		
	2005	2006	2007
	RMB	RMB	RMB
Total revenue	-	-	274
Total net loss	-	(1,604)	(14,315)



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2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

**Basis of presentation** - The consolidated financial statements of the Company have been prepared in accordance with the accounting principles generally accepted in the United States of America ("US GAAP"). All amounts in the accompanying consolidated financial statements and the related notes are expressed in Renminbi ("RMB"). The amounts expressed in United States dollars ("US\$") are presented solely for the convenience of the readers and are translated at a rate of RMB7.2946 to US\$1, the approximate rate of exchange at December 31, 2007. Such translations should not be construed to be the amounts that would have been reported under US GAAP.

**Basis of consolidation** - The consolidated financial statements include the financial statements of Ninetowns and its subsidiaries and VIEs. All significant intercompany transactions and balances are eliminated on consolidation.

**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 at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company bases its estimates on historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Significant accounting estimates reflected in the Company's consolidated financial statements include allowance for doubtful accounts, estimated cost to complete in a percentage of completion arrangement, estimated useful lives and impairment of acquired intangible assets and goodwill, valuation allowance for deferred tax assets and purchase price allocation relating to the business acquired.

**Cash and cash equivalents** - Cash and cash equivalents consist of cash on hand, demand deposits and highly liquid investments, which are unrestricted as to withdrawal and use, and have remaining maturities of three months or less when purchased.

**Restricted cash**—The Company's restricted cash is related to deposits required by certain customers for the software development services provided by the Company.

**Term deposits** - Term deposits consist of deposits placed with financial institutions with remaining maturity of greater than three months but less than one year.

**Short-term investments** – Short-term investments are comprised of marketable equity securities, which are classified as trading and available-for-sale. Marketable securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and are reported at fair value, with realized gains and losses recognized in earnings. The Company purchased and sold trading securities during 2007 but there were no outstanding balances at December 31, 2007. Short-term investments classified as available for sale are stated at fair values. Unrealized gains or losses for available for sale securities from the changes in fair value are recorded into equity account as other comprehensive income (loss). Realized gains or losses for disposal of available for sale securities are directly recorded in the consolidated statement of operations.

The Company reviews investment in available-for-sale securities at the end of each balance sheet date for other-than-temporary declines in fair value below the cost basis based on the specific identification method. If the Company determines a decline in fair value below the cost basis is other-than-temporary, accumulated unrealized loss

is accounted for as realized loss and included in earnings. No other-than temporary impairment losses were recorded during the years ended December 31, 2005, 2006 and 2007.

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## 2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

Inventories - Inventories are stated at the lower of cost or market price. Cost is determined by the weighted average method. Provision for diminution in value on inventories is made using specific identification method. No inventory provisions were made in 2005, 2006 and 2007.

Accounts receivable and allowance for doubtful accounts - Accounts receivable mainly represents amounts earned and are collectible from customers. Accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make the required payments and uses the specific identification method to record such allowances. Management of the Company considers the following factors when determining the collectability of accounts receivable: a customer's credit-worthiness, past collection history, and changes in a customer's payment terms. Allowance for doubtful accounts is made based on aging of accounts receivable and on any specifically identified accounts receivable that may become uncollectible.

Changes in the allowance for doubtful accounts were as follows:

	2006 RMB	2007 RMB
Balance at January 1,	4,851	1,088
Provision for allowance for doubtful debts	2,487	25,078
Recovery	(4,008)	(2,683)
Write offs	(2,242)	(184)
Balance at December 31,	1,088	23,299

Property and equipment - Property and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Buildings	20 years
Leasehold improvements	shorter of lease term or 5 years
Furniture, fixtures and office equipment	5 years
Computer equipment	5 years
Motor vehicles	5 years

Acquired intangible assets - Acquired intangible assets, which consist primarily of customer relationships, buyer database, completed technology and purchased software for internal use, are carried at cost, less accumulated amortization.

Amortization is calculated on a straight-line basis over the expected useful life of the assets of five years. Amortization expenses for the years ended December 31, 2005, 2006 and 2007 were RMB2,416 and RMB2,943 and RMB14,466 respectively.

Impairment of long-lived assets - The Company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When these events occur, the Company measures impairment by comparing the carrying amount of the assets to future undiscounted net cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, the Company would adjust the carrying value of the asset based on the fair value and

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## 2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

recognize an impairment loss. There were no impairment losses in the years ended December 31, 2005, 2006 and 2007.

Goodwill - Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. The Company completes a two-step goodwill impairment test. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill.

Management performed the annual goodwill impairment test as of December 31, 2005, 2006 and 2007 and no impairment losses were recorded in 2005 and 2006. In 2007, based on the impairment assessment performed by management, the Company incurred a total goodwill impairment charge of RMB193,570. This impairment charge is related to the Company's segments of enterprise software and related customer maintenance service and software development services. The Company's financial outlook from maintenance services of the free software offered by the Chinese government has been negatively impacted due to several factors. First, the Chinese government's declining promotion of its free software has resulted in a corresponding decline in the need for the Company's maintenance services. Additionally, the Company believes there is uncertainty surrounding the Chinese government's future promotional plans for its free software. As a result, the Company decided to revise downward the financial performance projection and assumptions of its enterprise software and related customer maintenance service segment, resulting in a goodwill impairment loss of RMB187,770 recognized for this segment. For the software development service segment, the Company has experienced a slowdown in the demand for such services by the government and therefore has also revised downward the financial performance projection and assumptions of this segment, resulting in an impairment loss of RMB5,800 recognized for this segment.

The changes in the carrying amount of goodwill by reporting unit for the years ended December 31, 2006 and 2007 were as follows:

	Enterprise software and related customer maintenance service RMB	Software development services RMB	B2B RMB	Total RMB
Balance as of January 1, 2006 and December 31, 2006	187,770	5,800	-	193,570
Goodwill acquired during the year	-	-	78,081	78,081
Goodwill impairment during the year	(187,770)	(5,800)	-	(193,570)
Balance as of December 31, 2007	-	-	78,081	78,081





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2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

Investments under cost method – For investment in an investee over which the Company does not have significant influence, the Company carries the investment at cost adjusted for other-than-temporary declines in fair value and recognizes income when receiving dividends from distribution of investee’s earnings. The Company reviews the investments under cost method for impairment whenever events or changes in circumstances indicate that the carrying value may no longer be recoverable. An impairment loss is recognized in earnings equal to the difference between the investment cost and its fair value at the balance sheet date of the reporting period for which the assessment is made. The fair value of the investment would then become the new cost basis of the investment. No impairment charges were recorded for the years ended December 31, 2005, 2006 and 2007.

Investment in an affiliate - Investment in an affiliate over which the Company exercises significant influence, but not control, are accounted for using the equity method. The Company's share of earnings (losses) of the affiliate is included in the consolidated statements of operations, The Company established its affiliate in 2007 and the affiliate had not commenced its operations at December 31, 2007.

Income taxes - Deferred income taxes are provided using the asset and liability method. Under this method, deferred income taxes are recognized for tax credits and net operating losses available for carry-forwards and significant temporary differences. Deferred tax assets and liabilities are classified as current or non-current based upon the classification of the related asset or liability in the financial statements or the expected timing of their reversal if they do not relate to a specific asset or liability. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of, the deferred tax assets will not be realized. Current income taxes are provided for in accordance with the laws and regulations applicable to the Company as enacted by the relevant tax authorities.

On January 1, 2007, the Company adopted FASB Interpretation No.48 (“FIN 48”), Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No.109. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The total amount of unrecognized tax benefits as of the date of adopting FIN 48 was RMB636 and a total FIN48 liability including late payment interest of RMB832 included in income tax expense in the income statement by the end of 2007. The Company's tax years from 2003 to 2007 are subject to examination by the tax authorities.

Revenue recognition –The Company's revenue is mainly derived from four primary sources: (i) sale of enterprise software and related customer maintenance services; (ii) software development services; (iii) sale of computer hardware and (iv) B2B search services.

Revenue from the sale of enterprise software and related customer maintenance service is recognized when there is evidence of an arrangement, the delivery or service has occurred, the fee is fixed or determinable, and collectability is probable. As the Company does not have vendor-specific objective evidence to establish the fair values of the undelivered elements, the Company recognizes revenue from sales of enterprise software and maintenance service on a straight-line basis over the service period which is typically 12 months.

For certain customers, the Company installs the software at the customer's place of business and charges the customer a fixed fee based on actual usage of the software. Accordingly, the Company recognizes the related revenue when the customer uses the software.

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2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

Revenues from software development services requiring significant production, modification, or customization of the software are recognized over the installation and customization period based on the percentage of completion method as prescribed by Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Product-Type Contracts". Percentage-of-completion is measured principally by the percentage of actual hours incurred to date for each contract to the estimated total hours to be incurred for each contract at completion.

Certain revenue from software development services also includes hardware procurement under customer's request. Since the Company does not have vendor-specific objective evidence to allow for separating various components of such software development service contracts, the Company recognizes such revenues when all components under the contracts are delivered and the project is completed upon the receipt of a written acceptance from the customer.

Sales of computer equipment and accessories are recorded when the goods are delivered, title is passed to the customers and the Company has no further obligations to provide services relating to the operation of such equipment.

The Company provides online business-to-business search services by selling keywords to improve the customers' rankings in search results on the Company's marketplaces. Service fees are paid in advance in respect of such services for a specific contracted service period. All service fees are initially deferred when received and revenue is recognized ratably over the term of the respective service contracts as the services are rendered.

The Company reports revenue net of business taxes. Business taxes included in revenue during 2005, 2006, and 2007 totaled RMB10,375, RMB4,919 and RMB4,402 respectively. Software revenue includes the benefit of the rebate of value added taxes on the sales of software and software-related services received from the Chinese tax authorities as part of the PRC government's policy of encouraging of software development in the PRC. Pursuant to certain PRC rules relating to value-added taxes, Beijing Ninetowns Times, Beijing Ninetowns Digital Technology, Beijing Ninetowns Ports and Beijing Ninetowns Network are entitled to a refund of value-added taxes paid at a rate of 14% of the sales value for self-developed software products, excluding revenues from maintenance services and upgrade rights that are sold separately. Revenues from the sale of software products include the refund of such value-added tax which totaled RMB19,766, RMB10,500 and RMB4,347 for the years ended December 31, 2005, 2006 and 2007, respectively.

Cost of revenue - Cost of revenue includes production costs for products sold, and direct costs associated with the delivery of software development and maintenance services, including salaries, employee benefits and overhead costs associated with employees providing the related services.

Research and Development - Research and development expenses include payroll, employee benefits and other costs associated with product development. Technological feasibility for the Company's software products is reached shortly before the products are released for production. Costs incurred after technological feasibility has historically been immaterial. Accordingly, the Company expenses all research and development costs when incurred.

Advertising costs - Advertising costs are expensed in the period incurred. The Company incurred advertising costs totaling RMB1,979, RMB2,281 and RMB6,277 during the years ended December 31, 2005, 2006 and 2007, respectively.

Government subsidies - Government subsidies represent amounts granted by local governments to reward companies that have made contributions in the development of the electronic and software industries as

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2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

well as those companies that contribute significantly to local taxes. The Company reports government subsidies when it becomes due and receivable and the Company does not have any obligations to repay the amounts received.

**Foreign currency translation** - The functional currency of the Company's subsidiaries and VIEs established in the PRC is the RMB. The functional currency of Ninetowns and its subsidiaries established in countries other than PRC is the US\$. Transactions dominated in other currencies are recorded in the applicable functional currencies at the rates of exchange prevailing when the transactions occur. Monetary assets and liabilities denominated in other currencies are translated into the applicable functional currencies at rates of exchange in effect at the balance sheet dates. Non-monetary assets and liabilities are remeasured into the applicable functional currencies at historical exchange rates. Exchange gains and losses are recorded in the consolidated statements of operations.

The Company has chosen the RMB as its reporting currency. Assets and liabilities are translated at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the year. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of other comprehensive loss in the statement of shareholders' equity.

**Comprehensive income** - Comprehensive income includes net income/(loss), foreign currency translation adjustments and unrealized gain or loss on investment in available-for-sale securities and is reported as a component of consolidated statements of shareholders' equity.

**Foreign currency risk** - The RMB is not a freely convertible currency. The State Administration for Foreign Exchange under the authority of the People's Bank of China controls the conversion of the RMB into foreign currencies. The value of the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market. Cash and cash equivalents and term deposits of the Company included aggregate amounts of RMB830,155 at December 31, 2006 and RMB637,270 at December 31, 2007 which were denominated in RMB.

**Concentration of credit risk** - Financial instruments that potentially expose the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, trade receivables, and term deposits. The Company places its cash and cash equivalents with financial institutions with high-credit ratings and quality. The Company conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Company establishes an allowance for doubtful accounts primarily based upon the age of the receivables and factors surrounding the credit risk of specific customers.

**Fair value of financial instruments** - The carrying amounts of cash and cash equivalents, term deposits, trade receivables, and accounts payable approximate their fair value due to the short-term nature of these instruments.

**Share-based compensation** - The Company grants stock options to its employees and directors. Prior to January 1, 2006, the Company accounted for employee share-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB Opinion 25"), and its related interpretations which required the Company to record a compensation charge for the excess of the fair value for the stock at the grant date over the amount an employee must pay to acquire the



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## 2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

stock. The compensation expense is recognized over the applicable service period, which is usually the vesting period.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standard ("SFAS") No. 123R, which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25. Effective January 1, 2006, the Company adopted SFAS No.123R and recognized compensation cost on a straight-line basis over the requisite service period which is the vesting period. The Company elected the modified prospective method. Under this method, share-based compensation expense recognized includes: (a) compensation expense for all share-based compensation awards granted prior to, but not yet vested as of January 1, 2006 based on the fair value as of the grant date, and (b) compensation expense for all share-based compensation awards granted on or subsequent to January 1, 2006, based on grant-date fair value.

For share-based compensation awards that were granted prior to January 1, 2006 that are not yet vested and continue to be reported under APB Opinion 25, the following is the Company's pro forma net income that would have been reported if such awards were accounted for under SFAS 123(R):

	Year ended December 31, 2005 RMB
Net income, as reported	151,604
Add: Share-based compensation, as reported	-
Less: Share-based compensation determined using the fair value method	(14,616)
Pro forma net income	136,988
Weighted average shares used in computation	
Basic	34,539,976
Diluted	35,706,894
Net income per share:	
Basic, as reported	4.39
Basic - pro forma	3.97
Diluted, as reported	4.25
Diluted - pro forma	3.84

The fair value of each option granted is estimated on the date of grant using the minimum value method for options granted before Ninetowns became a public company, as permitted for non-public companies, and using the Black-Scholes option pricing model for options granted after Ninetowns became a public company. The value of options was estimated on the date of the respective grant using the following weighted average assumptions:





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## 2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

The value of options granted was estimated on the date of grant using the following weighted average assumption:

## Options grants

Weighted average risk-free rate of return	5%
Weighted average expected option life	6.25 years
Weighted average volatility rate	55%
Weighted average dividend yield	0%

Net income(loss) per share - Basic net income per share is computed by dividing net income attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. Diluted net income per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised into ordinary shares. Ordinary share equivalents are excluded from the computation of the diluted net income per share in periods when their effect would be anti-dilutive.

Reclassification - Certain amounts and balances in the 2005 and 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation.

Recently Issued Accounting Pronouncements –In September 2006, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements”, which defines fair value, establishes a framework for measuring fair value in US GAAP, and expands disclosures about fair value measurement. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In February 2008, the FASB issued FASB Staff Position (“FSP”) 157-2, “Effective Date of FASB Statement No. 157”, which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at the fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 is effective for fiscal years beginning after July 1, 2008; FSP 157-2 delays the effective date for certain items to July 1, 2009. The Company is currently assessing the potential impact that adoption of this statement may have on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115". SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the Company has chosen to use fair value on the face of the balance sheet. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company believes there will be no material impact on its financial statements upon adoption of this standard.

In December 2007, the Financial Accounting Standards Board issued FASB Statement No. 141 (Revised 2007), Business Combinations (“SFAS 141R”). SFAS 141R provides additional guidance on improving the relevance, representational faithfulness, and comparability of the financial information that a reporting entity provides in its financial reports about a business combination and its effects. This Statement applies prospectively to business

combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company has not yet begun the process of assessing the potential impact the adoption of SFAS No. 141R may have on its consolidated financial position or results of operations.

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2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

In December 2007, the Financial Accounting Standards Board issued FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 (“SFAS 160”). SFAS 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This Statement is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company has not yet begun the process of assessing the potential impact the adoption of SFAS No. 160 may have on its consolidated financial position or results of operations.

In March 19, 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities” to improve the relevance, comparability, and transparency of financial information provided to investors by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format, cross-referencing within footnotes to enable financial statement users to locate important information, and the disclosure of derivative features that are credit risk-related. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company has not yet begun the process of assessing the potential impact the adoption of SFAS No. 161 may have on its consolidated financial position or results of operations.

3. ACQUISITIONS

Acquisition of 70% equity interest in Ample Spring and Baichuan Tongda

In April 2007, the Company acquired a 70% equity interests in both Ample Spring and Baichuan Tongda for the purpose of engaging in B2B search business. Baichuan Tongda is a vertical search engine provider established in February 2004 in the PRC. Ample Spring was set up in January 2007 in BVI by the same shareholders of Baichuan Tongda for the purpose of receiving payments only. Therefore, the acquisitions of 70% equity interest in Ample Spring and in Baichuan Tongda are treated as a single transaction. Total consideration for this single transaction is RMB105,000, which was paid in 2007. Because PRC regulations prohibit direct foreign ownership of business entities providing internet content, or ICP, services in the PRC such as Baichuan Tongda's online B2B search service, the acquisition of 70% equity interest in Baichuan Tongda was actually through contractual arrangements as described in Note 1.

The acquisition is accounted for using purchase method of accounting. The results of operations of Baichuan Tongda have been included in the Company's consolidated financial statements from the date of acquisition.

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## 3. ACQUISITIONS - continued

The Company's purchase price was allocated as follows:

	RMB	Estimated useful life
Current assets	4,592	
Non-current assets	6,075	
Current liabilities	(20,726)	
Non-current liabilities	(17,106)	
Intangible assets acquired:		
Customer relationship	2,455	5 years
Buyer database	2,044	5 years
Completed technology	61,121	5 years
Goodwill	78,081	
Minority interest	(11,536)	
<b>Total consideration</b>	<b>105,000</b>	

The fair values of the intangible assets were determined using the "cost", "income approach-excess earnings" and "relief from royalty" valuation methods. In performing the purchase price allocation, the Company considered, among other factors, forecasted financial performance of the acquired business, market performance, and the market potential of the acquired business in China. The acquired goodwill is not deductible for tax purposes.

The following unaudited pro forma information summarizes the results of operations for the Company, including the acquisition of a 70% interest in Ample Spring, assuming that the acquisition occurred as of January 1, 2006, and 2007 respectively. The following pro forma financial information is not necessarily indicative of the results that would have occurred had the acquisitions been completed at the beginning of the periods indicated, nor is it indicative of future operating results:

	Years Ended December 31,	
	2006 RMB (Unaudited)	2007 RMB (Unaudited)
Total revenue	158,173	107,908
Net income (loss)	36,717	(238,661)
Net income (loss) per share		
- Basic	1.06	(6.83)
- Diluted	1.04	(6.83)

The pro forma results of operations give effect to certain pro forma adjustments, including amortization of acquired intangible assets with definite lives associated with the acquisition.



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## 4. SHORT-TERM INVESTMENTS

Short-term investments are classified as available-for-sale securities. Available-for-sale securities consisted principally of balanced funds issued by major financial institutes.

	December 31, 2007			December 31, 2006				
	Cost	Gross unrealized gains	Gross unrealized (losses)	Fair value	Cost	Gross unrealized gains	Gross unrealized (losses)	Fair value
Balanced	8,088	2,874	-	10,962	-	-	-	-
Total	8,088	2,874	-	10,962	-	-	-	-

As of December 31, 2007, the Company realized total gains of RMB43,546 (proceeds from the sale of trading securities of RMB94,834 with an aggregate cost of RMB51,630 and proceeds from the sale of available-for-sale securities of RMB2,330 with an aggregate historical cost of RMB1,988) during the year 2007.

## 5. INVENTORIES

Inventories consisted of the following:

	Years Ended December 31,	
	2006	2007
	RMB	RMB
Computer accessories	5,777	6,952
Third party software products	1,041	58
Other supplies	2	1
	6,820	7,011

Inventories were purchased for software development service projects after the requirements for such projects were determined. No provision for obsolete or impaired inventories were considered necessary because inventories were purchased only for on-going software development service projects where the specific inventory requirements have been agreed to in contracts with the customers and certain customers are required to pay a significant deposit for such projects prior to their inception.

## 6. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expense and other current assets consisted of the following:

	Years Ended December 31,	
	2006	2007
	RMB	RMB
Advance to employees	2,434	4,847
Prepayments	7,093	3,864
Deposits for exhibition, office rental, utilities and purchase of property and equipment	10,885	6,928

Interest receivable for term deposits	6,602	446
Value added tax recoverable	425	451
Other receivables	214	523
	27,653	17,059

## 7. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consisted of the following:

	Years Ended December 31,	
	2006	2007
	RMB	RMB
Buildings	20,108	158,053
Leasehold improvements	8,244	6,484
Furniture, fixtures and office equipment	3,216	4,998
Computer equipment	23,940	34,384
Motor vehicles	3,746	4,238
Total	59,254	208,157



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Less: accumulated depreciation and amortization	(12,561)	(18,380)
Property and equipment, net	46,693	189,777

Depreciation and amortization expenses for the years ended December 31, 2005, 2006 and 2007 were RMB 2,877, RMB6,194 and RMB9,867, respectively.

8. INVESTMENT IN AN AFFILIATE

In May 2007, the Company, together with the Technology Center of Guangdong Inspection and Quarantine Bureau, established Guangzhou Yuejiu Inspection Technology Service Co. Ltd. ("Yuejiu") in the PRC for the purpose of providing import and export services in Guangzhou and holds a 49% equity interest in Yuejiu for RMB2,450. Yuejiu had not commenced its operations at December 31, 2007.

9. INVESTMENTS UNDER COST METHOD

	Years Ended December 31,	
	2006 RMB	2007 RMB
Global Market	38,929	36,286
Tophere	-	4,500
	38,929	40,786

In September 2006, the Company entered into a subscription agreement with Global Market Group Limited ("Global Market") to subscribe 1,940,000 Series A preferred shares, which represents 16.25% of the fully dilute equity interest in Global Market on an if-converted basis, for a cash consideration of RMB38,929 (US\$5,000). Because the Company cannot exercise significant influence, the investment is accounted for under the cost method.

The subscription agreement contains put and call options. The call option gives the Company a right to acquire a variable number of Global Market's ordinary shares at a nominal price of US\$1 in the event Global Market's earnings fall below a predetermined level or receive cash if additional earnings requirements are not met. The put option gives Global Market a right to repurchase up to 285,000 of issued ordinary shares from the Company at a nominal price of US\$1 when Global Market's earnings are above a predetermined level. In 2007, both the Company and Global Market waived these put and call options.

In November 2007, the Company entered into an agreement with Hangzhou Tophere Info-Tech Inc., ("Tophere"), a Chinese business-to-business ("B2B") food and beverage trade facilitator headquartered in Hangzhou, to acquire 19.8% equity interest with a cash consideration of RMB4,500. Because the Company cannot exercise significant influence, the investment is accounted for under the cost method.

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## 10. ACQUIRED INTANGIBLE ASSETS, NET

Acquired intangible assets, net consisted of the following:

	Years Ended December 31,	
	2006 RMB	2007 RMB
Customer lists and relationships	6,131	8,586
Completed technology	5,251	66,372
Buyer database	-	2,044
Purchased software for internal use	17,200	17,200
Total	28,582	94,202
Less: accumulated amortization	(5,885)	(20,351)
Acquired intangible assets, net	22,697	73,851

Purchased software for internal use represents the perpetual license of "Dongguan iDeclare Version 1.0 " acquired from the Department Service Center of Dongguan Entry-Exit Inspection and Quarantine Bureau ("Dongguan CIQ") and is only used internally by the Company.

Amortization expenses for the years ended December 31, 2005, 2006, and 2007 were RMB2,416, RMB2,943, and RMB14,466 respectively.

The following table represents the total estimated amortization of intangible assets for the five succeeding years:

For the Year Ending December 31	Estimated Amortization Expense
2008	RMB18,840
2009	18,081
2010	16,564
2011	15,991
2012	4,375
	73,851

## 11. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses included the following:

	Years Ended December 31,	
	2006 RMB	2007 RMB
Accounts payable	2,694	5,408
Office expenses payable	1,437	1,498
Accrued expenses	1,009	4,091

Salary and wages	4,381	4,983
Staff welfare	508	485
Professional fees	4,283	2,795
	14,312	19,260

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12. INCOME TAXES

Ninetowns is a tax exempted company incorporated in the Cayman Islands. No provision for Hong Kong Profits Tax has been made as the subsidiaries incorporated in Hong Kong had no assessable profits earned or derived from Hong Kong during the three years ended December 31, 2005, 2006 and 2007. The subsidiaries incorporated in the PRC other than Hong Kong are governed by the Income Tax Law of PRC. Concerning Foreign Investment and Foreign Enterprises and various local income tax laws (the "Income Tax Laws").

The PRC subsidiaries are generally subject to a 25% corporate income tax except for certain entities that still enjoy the tax holidays which were grandfathered by the China new tax law effective January 1, 2008.

On March 16, 2007, the National People's Congress adopted the Enterprise Income Tax Law (the "New Income Tax Law"), which will become effective as of January 1, 2008 and replaced the existing separate income tax laws for domestic enterprises and foreign-invested enterprises, which are PRC subsidiaries of the Company, by adopting an unified income tax rate of 25% for most enterprises. In accordance with the implementation rules of the New Income Tax Law, the existing preferential tax treatments granted to Beijing New Take, Beijing Ninetowns Times, Beijing Ninetowns Digital Technology, Beijing Ninetowns Ports, Guangdong Ninetowns, Beijing Ninetowns Network Software and Beijing Ronghe Tongshang which each previously qualified as a "New and High Technology Enterprise" entitled them to enjoy tax holidays and tax concessions. Under the New Income Tax Law if they wish to qualify for such a preferential rate for years commencing on or after January 1, 2008, they will need to qualify as a "High and New Technology Enterprise Strongly Supported by the State" under the new rules. Until these subsidiaries and VIEs receive official approval for this new status, they will be subject to the statutory 25% tax rate and therefore have used such rate in the calculation of deferred tax balances.

Furthermore, under the New Income Tax Law, a "resident enterprise" which includes an enterprise established outside of the PRC with management located in the PRC, will be subject to PRC income tax. If the PRC tax authorities subsequently determine that the Company and its subsidiaries registered outside the PRC should be deemed a resident enterprise, the Company and its subsidiaries registered outside the PRC will be subject to the PRC income tax at a rate of 25%.

Under the New EIT law effective from January 1, 2008, the rules for determining whether an entity is resident in the PRC for tax purposes have changed and the determination of residence depends amongst other things on the "place of actual management". If the Company, or its non-PRC subsidiaries, were to be determined to be PRC resident for tax purposes, it or they, would be subject to tax in the PRC on its worldwide income including the income arising in jurisdictions outside the PRC. The Company is still evaluating its resident status under the new law and related guidance.

Beijing New Take and Beijing Ninetowns Times were awarded the certificate of "New and High Technology Enterprise" by Beijing Municipal Science and Technology Committee on March 30, 2001 and were exempted from the enterprise income tax for the two years ended December 31, 2002, followed by a 50% tax reduction for the three years ended December 31, 2005 at an income tax rate of 7.5%. Commencing from January 1, 2006, Beijing New Take and Beijing Ninetowns Times were subject to an enterprise income tax rate of 15% in 2007,

Beijing Ninetowns Digital Technology is qualified as a "New and High Technology Enterprise" and is subject to an enterprise income tax rate of 15% in 2007.



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## 12. INCOME TAXES – continued

Shanghai New Take was exempted from enterprise income tax for the two years ended December 31, 2004, followed by a 50% tax reduction for the three years ending December 31, 2007 at an income tax rate of 16.5%.

Beijing Ninetowns Ports was awarded the certificate of "New and High Technology Enterprise" and is exempted from the enterprise income tax for the three years ended December 31, 2005, followed by a 50% tax reduction for 2006 and 2007. Based on the recently issued tax regulation, Beijing Ninetowns Ports will be and subject to income tax rate of 7.5%, 25% in 2008 and 2009, respectively.

Guangdong Ninetowns has been awarded the certificate of "New and High Technology Enterprise" and is exempted from the enterprise income tax for the two years ending December 31, 2007. Based on the recently issued tax regulation, Guangdong Ninetowns will be subject to income tax rates of 12.5%, 12.5%, 12.5% and 25% in 2008, 2009, 2010 and 2011, respectively.

Beijing Ninetowns Network Software has been awarded the certificate of "New and High Technology Enterprise" and is exempted from the enterprise income tax for the three years starting from year 2006. Beijing Ninetowns Network Software is exempted from enterprise income tax for 2006 and 2007. Based on the recently issued tax regulation, Beijing Nintowns Network Software will be subject to income tax rates of nil, 12.5%, 12.5%, 12.5% and 25% in 2008, 2009, 2010, 2011 and 2012, respectively.

Beijing Ronghe Tongshang was qualified as a "New and High Technology Enterprise" and is exempt from the enterprise income tax in 2007.

Baichuan Tongda was acquired in April 2007 and subject to an income tax rate of 33% in 2007.

During the years ended December 31, 2005, 2006 and 2007, if the Company's subsidiaries in the PRC had not been awarded tax holidays or had special tax concessions, they would have recorded additional provision for income taxes totaling RMB43,235, RMB11,251 and RMB23,501, respectively, and the Company's net income would have been decreased by same amount accordingly. Basic net income or loss per share would have been changed to RMB3.14, RMB0.99 and RMB(7.26), and diluted net income or loss per share would have been changed to RMB3.04, RMB0.97 and RMB(7.26), for the years ended December 31, 2005, 2006, and 2007, respectively.

Provision for income taxes consisted of the following:

	Years Ended December 31		
	2005	2006	2007
	RMB	RMB	RMB
Current tax	626	2,102	1,367
Deferred tax	-	(1,071)	(1,124)
	626	1,031	243

As of December 31, 2007, significant temporary differences between the tax basis and financial statement basis of accounting for assets and liabilities that gave rise to deferred taxes were principally related to the following:



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## 12. INCOME TAXES – continued

	Years Ended December 31	
	2006	2007
	RMB	RMB
Current deferred tax assets		
Short-term deferred revenue (B2G)	2,260	1,300
Short-term deferred revenue (B2B)	-	62
Less: valuation allowance	(562)	(62)
Current deferred tax assets	1,698	1,300
Non-current deferred tax assets		
Net operating loss carried forward	4,610	7,186
Less: valuation allowance	(4,610)	(7,186)
Non-current deferred tax assets	-	-
Non-current deferred tax liabilities		
Accelerated depreciation of equipment	(627)	(1,992)
Amortization of intangible assets	-	(14,218)
Non-current deferred tax liabilities	(627)	(16,210)

The Company has operating loss carried forwards totaling RMB28,889 for the year ended December 31, 2007, the amount of which was all from the PRC subsidiaries and will expire on various dates from December 31, 2008 to December 31, 2012.

As of December 31, 2007, a valuation allowance of RMB7,186 was provided against deferred tax assets arising from net operating loss carry-forward, short-term deferred revenue of certain PRC subsidiaries and VIE due to the uncertainty of realization. Adjustment will be made to the valuation allowance if events occur in the future that indicates changes in the amount of deferred tax assets that may be realized.

The Company operates through multiple subsidiaries and VIEs and the valuation allowances are considered separately for each subsidiary and VIE. The Company does not file consolidated tax returns, therefore, losses and deferred taxes from one subsidiary or VIE may not be used to offset another subsidiary or VIE's earnings or deferred taxes.

If the Company were to be non-resident for PRC tax purposes, dividends paid to it out of profits earned after January 1, 2008 would be subject to a withholding tax. In the cases of dividends paid by PRC subsidiaries the withholding tax would be 10% and in the case of a subsidiary 25% or more directly owned by the resident in the Hong Kong SAR, the withholding tax would be 5%.

Aggregate undistributed earnings of the Company's subsidiaries, VIEs and its VIEs' located in the PRC that are available for distribution to the Company of approximately 540,079 at December 31, 2007 are considered to be indefinitely reinvested under APB opinion No. 23, and accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon the distribution of those amounts to the Company. The Chinese tax authorities have also clarified that distribution made out of pre January 1, 2008 retained earnings will not



be subject to the withholding tax.

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12. INCOME TAXES – continued

Due to the changes in the new tax law, the Company's deferred tax balances were calculated based on the newly enacted tax rate to be effective January 1, 2008. The impact on the deferred taxes resulting from the rate change as of January 1, 2008 is an adjustment to the net deferred tax liabilities of \$578, representing an increase in deferred tax liabilities and a decrease in deferred tax benefit. The Company also recorded higher deferred tax assets for certain of its PRC subsidiaries at the 25% rate but because of full valuation allowance on these PRC subsidiaries, the change in statutory tax rate has resulted in no net effect to current year's income tax provision for these entities.

Reconciliation between the provision for (benefit of) income taxes computed by applying the PRC statutory income tax rate of 33% to income (loss) before income taxes and the actual provision for income taxes is as follows:

	Years Ended December 31,		
	2005	2006	2007
PRC statutory income tax	33.0%	33.0%	(33.0%)
Expenses not deductible for tax purposes	10.2%	2.9%	5.6%
Permanent differences	(5.9%)	(5.1%)	9.5%
Tax exemption and tax relief granted to PRC subsidiaries	(36.9%)	(28.6%)	17.9%
Effect on deferred taxes due to changes in tax rates under the new law for certain subsidiaries	-	-	(0.1%)
	0.4%	2.2%	(0.1%)

Effective on January 1, 2007, the Company adopted the provisions of FIN 48.

The total amount of unrecognized tax benefits as of the date of adoption was RMB636. As a result of the implementation of FIN 48, the Company recognized a RMB636 increase in retained earnings for unrecognized tax benefits. As of December 31, 2007, the Company recorded an additional RMB196 for unrecognized tax benefits. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2007	636
Additions based on tax positions related to the current year	196
Balance at December 31, 2007	832

The Company does not anticipate any significant change within 12 months of this reporting date of its uncertain tax positions.

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## 13. OTHER TAXES PAYABLE

	Years Ended December 31,	
	2006	2007
	RMB	RMB
Individual income tax withheld	209	605
Business tax payable	2,491	1,628
Value added taxes payable, net	(368)	(645)
	2,332	1,588

The Company's subsidiaries in the PRC other than Hong Kong are subject to a 17% value added tax on revenues from the sales of hardware to customers and, in addition, are subject to business taxes and value added taxes at the rates of 5% and 3%, on service revenues from software development and sales of software, respectively. Value added taxes payable for hardware sales is reported net of value added taxes paid for inventory purchases. The Company is also required to withhold PRC individual income taxes on employees' payroll for remittance to the tax authorities.

## 14. NET INCOME (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted income per share for the periods indicated:

	Years ended December 31,		
	2005	2006	2007
Numerator used in basic net income per share:			
Net income (loss)	151,604	45,928	(230,531)
Shares (denominator):			
Weighted average ordinary shares outstanding	34,539,976	34,773,005	34,966,830
Plus: incremental shares from assumed conversion of stock options	1,166,918	595,877	-
Weighted average ordinary shares outstanding used in computing diluted net income (loss) per ordinary share	35,706,894	35,368,882	34,966,830
Net income (loss) per ordinary share - basic	4.39	1.32	(6.59)
Net income (loss) per ordinary share-diluted	4.25	1.30	(6.59)

As of December 31, 2006 and 2007, the Company had 1,716,653 and nil ordinary shares equivalents outstanding that could have potentially diluted basic income (loss) per share in the future, but which were excluded in the computation of diluted income (loss) per share in the years presented, as their effect would have been anti-dilutive.



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15. RELATED PARTY TRANSACTIONS AND BALANCES

Purchase of office spaces

In June 2004, the Company acquired office premises from a company affiliated with a director of Jitter Bug. In 2005, 2006 and 2007, the Company acquired an additional office space from the same seller and paid for the full amount of RMB18,617, RMB47,339 and RMB47,487, respectively. As of December 31, 2007, the building was completed and the amount paid was reported as property in the accompanying consolidated balance sheets.

Software development services

During the years ended December 31, 2005, 2006 and 2007, the Company provided software development services to Beijing iTowNet Cyber Technology Ltd. ("Beijing iTownNet") in which two of the Company's senior management serve as director and supervisor.

The Company provides software development services to eGrid Technology Ltd. ("eGrid") which in turn provides the services to Beijing iTowNet. The Company recognized net revenues of RMB22,160, RMB7,263 and RMB nil from services provided indirectly to Beijing iTowNet through eGrid during 2005, 2006 and 2007, respectively. For the years ended December 31, 2005, 2006 and 2007, RMB270, RMB nil, and RMB nil were recognized from software development services provided directly to Beijing iTowNet. The Company also provided platform maintenance services to Beijing iTowNet directly as well as indirectly through eGrid during the years ended December 31, 2005 and 2006, and recognized net revenues of RMB5,670 and RMB5,670, respectively, from such services. The Company did not provide such maintenance services to Beijing iTowNet in 2007.

Sales of enterprises software and related customer maintenance service:

The Company has an agreement with Shenzhen Ninetowns Enke Software Technology Co., Ltd. ("Ninetowns Enke"), a company owned by two of the Company's senior management, for the distribution of the Company's enterprise software in the southern region of the PRC. During the years ended December 31, 2005, 2006 and 2007, the Company recognized net revenues of RMB47,500, RMB21,240 and RMB2,937, respectively, from the sales of enterprise software and related customer maintenance service to Ninetowns Enke.

The Company signed an agreement with Guangzhou Wangli Software Co., Ltd. ("Guangzhou Wangli"), a company owned by a minority shareholder of one of the Company's VIEs, for the distribution of the Company's enterprise software in the PRC. During the years ended December 31, 2006 and 2007, the Company recognized net revenues of RMB475 and RMB6,348, respectively, from the sales of enterprise software and related customer maintenance services to Guangzhou Wangli.

The Company sold software products to Beijing iTowNet, directly and indirectly, amounting to RMB13,454, RMB3,466 and RMB229 in the years ended December 31, 2005, 2006 and 2007, respectively.

Other:

In November 2004, the Company entered into an option agreement to acquire 49% of ownership interest in Beijing iTowNet exercisable at the Company's option. In the event such purchase becomes permissible under the relevant laws

of the PRC and the Company exercises its option, the purchase price will be RMB206,915 (US\$25 million) plus an amount calculated at 5% per year compounded annually for the years the selling company held an ownership interest in iTowNet less any dividends or distributions the selling company received during its ownership of Beijing iTowNet.

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15. RELATED PARTY TRANSACTIONS AND BALANCES - continued

Related party balances:

Trade receivables at December 31, 2006 and 2007 included RMB2,780 and nil from eGrid, and RMB1,183 and RMB546 from Ninetowns Enke, and RMB1,485 and RMB 5,804 from Guangzhou Wangli respectively. The amounts were unsecured, interest free, and repayable on demand.

As of December 31, 2006 and 2007, amount due to an affiliate, Guangzhou Yuejiu, are nil and RMB1,450, respectively. The amount is unsecured, interest free and is expected to be collected within one year.

16. SHARE OPTION PLANS

The 2003 Plan

On November 18, 2003, Ninetowns granted 2,574,400 options to certain employees and directors for the purchase of 2,574,400 ordinary shares at an exercise price of RMB26 (HK\$25) per share. The options will vest over three years at 25% per year through November 18, 2006. Any option not exercised will expire on November 17, 2013. The 2003 Plan will remain in effect for ten years starting from the date of adoption.

As of December 31, 2006 and 2007, options to purchase 1,716,653 and 1,398,751 ordinary shares were outstanding, respectively. As of December 31, 2006 and 2007, there were no options available under the 2003 Plan for future grants.

The 2004 Plan (as amended)

Under the 2004 Plan, as amended, Ninetowns may grant options to its employees for the purchase of up to 4.3 million ordinary shares at prices to be determined by Ninetowns' Board of Directors. The 2004 Plan, as amended also permits Ninetowns to grant share appreciation rights, restricted share awards, and performance awards. The Amended and Restated 2004 Plan will automatically terminate in 2015, unless Ninetowns terminates it earlier.

On February 23, 2005, Ninetowns granted 890,000 options to certain employees to purchase 890,000 ordinary shares at an exercise price of RMB71 (US\$8.6) per share which was the closing fair value of Ninetowns' ordinary shares the day before the grant date. The options will vest over four years at 25% per year from the grant date. Any options granted but not exercised will expire on February 22, 2015.

As of December 31, 2006 and 2007, options to purchase 784,294 and 632,222 ordinary shares were outstanding, respectively. As of December 31, 2006 and 2007, 3,410,000 options to purchase ordinary shares were available under the 2004 Plan, as amended, for future grants.

The 2006 Plan

In December 2005, the shareholders of Ninetowns approved the 2006 stock incentive plan (the "2006 Plan") which allows the Company to offer a variety of share-based awards to employees and employees of the Company's affiliates and subsidiaries including share options, restricted shares, and other similar awards. The exercise price must be at

least equal to 100% of the fair market value of the ordinary shares on the grant date. The 2006 Plan will be automatically terminated in 2015. At December 31, 2007, the Company had not granted any options or other types of awards under the 2006 Plan.

A summary of the share option activities was as follows:

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## 16. SHARE OPTION PLANS - continued

	2005		Years ended December 31, 2006		2007	
	Number of options	Weighted Average Exercise price	Number of options	Weighted Average Exercise price	Number of options	Weighted Average Exercise price
Outstanding at beginning of year	2,328,894	26	2,877,097	39	2,500,947	40
Granted	890,000	71	-	-	-	-
Exercised	(284,774)	26	(267,364)	26	(47,862)	26
Cancelled	(57,023)	71	(108,786)	46	(422,112)	39
Outstanding at end of year	2,877,097	39	2,500,947	40	2,030,973	40
Exercisable at end of year	1,400,520	26	1,920,366	31	1,872,918	37

The total intrinsic value of options exercised during the years ended December 31, 2005, 2006, and 2007 was RMB8.2 million, RMB3.6 million, and RMB0.6 million, respectively. At December 31, 2007, both the aggregate intrinsic value of options outstanding and options exercisable were RMB nil.

	Options outstanding			Options exercisable		
	Number outstanding	Weighted average remaining contractual life	Fair value per share at grant date	Weighted average exercise price (RMB)	Number exercisable	Weighted average exercise price (RMB)
	1,398,751	5.875	RMB0.297 (HK\$0.286)	26	1,398,751	26
	632,222	7.167	RMB40.42 (US\$4.896)	71	474,167	71
	2,030,973	6.277		40	1,872,918	37

As of December 31, 2007, the unrecognized share-based compensation cost amounted to RMB1,796 and is expected to be recognized over a weighted-average vesting period of 1.25 years.

The amount of stock-based compensation attributable to cost of revenues, sales and marketing, general and administrative expenses, and research and development is included in those line items in the accompanying consolidated statements of operations. Stock-based compensation expense related to stock options is as follows:

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## 16. SHARE OPTION PLANS - continued

	Years Ended December 31,		
	2005	2006	2007
Cost of revenues	-	1,039	126
Sales and marketing	-	3,371	628
General and administrative	-	4,074	1,145
Research and development	-	1,843	27
Total stock-based compensation expense	-	10,327	1,926

## 17. COMMITMENTS

The Company has operating lease agreements principally for its office properties in the PRC. Such leases have remaining terms ranging from 12 to 24 months and are renewable subject to negotiation. Rental expense was RMB6,581, RMB7,552 and RMB11,699, for the years ended December 31, 2005, 2006 and 2007, respectively.

Future minimum lease payments under non-cancellable operating lease agreements at December 31, 2007 were as follows:

	RMB
Year ending December 31:	
2008	1,158
2009 and afterwards	496
<b>Total</b>	<b>1,654</b>

The Company has entered into franchise agreements to undertake marketing, distribution and service activities. Under such agreements, the Company is obligated to provide advertising, training and telephone support associated with the software license and products. The Company did not have any significant outstanding obligation and commitment at December 31, 2007.

At December 31, 2007, the Company is committed to inject further capital of RMB102.5 million into Ample Spring, a 70%-owned subsidiary of the Company no later than one year after the establishment of a wholly foreign-owned enterprise in the PRC ("WFOE") and the execution of an exclusive business cooperation agreement between this WFOE and Baichuan Tongda.

## 18. SEGMENT INFORMATION

Before 2007, the Company had three operating segments: enterprise software segment, software development services segment, and computer hardware sales segment. The enterprise software segment is engaged in the development, distribution and sale of software products, the provision of customer maintenance services to end-users, and the research and development of new enterprise software. The software development services segment is responsible for the development and integration of software in accordance with the customers' specifications and requirements. The

computer hardware sales segment is engaged in the sale of computer hardware and accessories. These three segments are all under the Company's business to government ("B2G") division.

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18. SEGMENT INFORMATION - continued

In the second quarter of 2007, the Company completed the acquisition of Ample Spring and Baichuan Tongda, a vertical search engine services provider and formally launched the Company's B2B search services and services platform, tootoo.com. As a result, the Company has a new operating segment, i.e., B2B, which provides online business-to-business search services by selling keywords to improve the customers' rankings in search results on the Company's marketplaces.

The Company follows the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, which establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company's chief operating decision maker is the Chief Executive Officer. Segment information provided to the chief operating decision maker is prepared using the accounting principles and the relevant financial regulations applicable to enterprises with foreign investment as established by the Ministry of Finance in the PRC ("PRC GAAP"). The principal differences between PRC GAAP and US GAAP as they relate to the Company are primarily (i) revenue recognition from the sale of enterprise software, (ii) the classification of PRC value added tax refund, and (iii) the recognition of share-based compensation expenses.

The Company's reportable segments offer different products and services. Each reportable segment is assigned a member of senior management who has knowledge about the products and services, specific operational risks, and opportunities associated with the segment.

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## 18. SEGMENT INFORMATION - continued

The following is a summary of financial information relating to each segment expressed under PRC GAAP:

## Year Ended December 31, 2005

	Enterprise software and related customer maintenance service RMB	Software development services RMB	Computer hardware sales RMB	Total RMB
Net revenues from external customers	109,022	7,600	678	117,300
Net revenues from related parties	39,081	28,100	-	67,181
Gross profit	147,278	17,838	196	165,312

## Year Ended December 31, 2006

	Enterprise software and related customer maintenance service RMB	Software development services RMB	Computer hardware sales RMB	Total RMB
Net revenues from external customers	73,123	23,084	398	96,605
Net revenues from related parties	11,450	12,933	-	24,383
Gross profit	84,573	20,251	264	105,088

## Year Ended December 31, 2006

	Enterprise software and related customer maintenance service RMB	Software development services RMB	Computer hardware sales RMB	B2B RMB	Total RMB
Net revenues from external customers	52,481	25,642	-	489	78,612
Net revenues from related parties	8,241	-	-	-	8,241
Gross profit (loss)	60,848	7,894	-	(4,620)	64,122

The Company does not allocate operating expenses to individual segments when making decisions about allocating resources to the segments and assessing their performance.

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## 18. SEGMENT INFORMATION - continued

The following is a reconciliation of the amounts presented for reportable segments under PRC GAAP to the consolidated totals reported under US GAAP:

	Years Ended December 31,		
	2005 RMB	2006 RMB	2007 RMB
Net revenues from external customers under PRC GAAP	117,300	96,605	78,612
U.S. GAAP adjustments:			
Differences in the timing of revenue recognition	21,232	11,455	11,346
PRC value added tax refund	12,280	7,549	3,995
<b>Total net revenues from external customers under US GAAP</b>	<b>150,812</b>	<b>115,609</b>	<b>93,953</b>
Net revenues from related parties under PRC GAAP	67,181	24,383	8,241
U.S. GAAP adjustments:			
Differences in the timing of revenue recognition	14,387	10,304	912
PRC value added tax refund	7,486	2,952	352
<b>Total net revenues from related parties under US GAAP</b>	<b>89,054</b>	<b>37,639</b>	<b>9,505</b>
Gross profit under PRC GAAP	165,312	105,088	64,122
U.S. GAAP adjustments:			
Differences in the timing of revenue recognition	35,619	21,759	12,258
PRC value added tax refund	19,766	10,501	4,347
Share-based compensation expenses	-	(1,039)	(126)
<b>Gross profit under US GAAP</b>	<b>220,697</b>	<b>136,309</b>	<b>80,601</b>
Operating expenses	(86,539)	(109,357)	(375,388)
Government subsidies	447	705	1,015
Income (loss) from operations	134,605	27,657	(293,772)
Interest income	17,625	19,302	13,885
Gains on disposal of available-for-sale securities	-	-	43,546
Income (loss) before income tax expenses	152,230	46,959	(236,341)



The Company primarily operates in the PRC. All the long-lived assets of the Company are located in the PRC and the Company does not allocate such assets to individual segments.

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## 19. MAJOR CUSTOMERS

Details of the customers accounting for 10% or more of net revenue are as follows:

Years ended December 31,			
Customer	2005	2006	2007
A	18%	9%	*
B	10%	11%	*
C	*	*	17%
D	*	*	23%
E	20%	14%	*
F	12%	*	*

\* Represents less than 10% of total net revenue.

## 20. EMPLOYEE BENEFIT PLANS

Employees of the Company located in the PRC other than Hong Kong are covered by the retirement schemes defined by local practice and regulations, which are essentially defined contribution schemes. The calculation of contributions for the eligible employees is based on 20% of the applicable payroll costs. Certain employees of the Company who are located in Hong Kong have joined the Mandatory Provident Fund ("MPF") Scheme which is also a defined contribution scheme. The contribution to the MPF Scheme is calculated based on the rules set out in the MPF Ordinance in Hong Kong which is 5% on the relevant income of the employee with a specific ceiling. The expenses paid by the Company to these defined contribution schemes were RMB2,566, RMB4,587, and RMB5,029 for the years ended December 31, 2005, 2006, and 2007, respectively.

In addition, the Company is required by law to contribute approximately 10%, 1.5%, and 1.3% of applicable salaries of certain employees for medical and unemployment benefits and workers compensation, respectively. The PRC government is directly responsible for the payments of the benefits to these employees. The amounts contributed were RMB1,523, RMB2,889, and RMB3,219 for the years ended December 31, 2005, 2006, and 2007, respectively.

## 21. CHINA CONTRIBUTION PLAN AND PROFIT APPROPRIATION

As stipulated by the relevant law and regulations in the PRC, the Company's subsidiary and variable interest entity in the PRC are required to maintain non-distributable statutory surplus reserve. Appropriations to the statutory surplus reserve are required to be made at not less than 10% of profit after taxes as reported in these entities' statutory financial statements prepared under PRC GAAP. Once appropriated, these amounts are not available for future distribution to owners or shareholders. Once the general reserve is accumulated to 50% of these entities registered capital, these entities can choose not to provide more reserves. The statutory reserve may be applied against prior year losses, if any, and may be used for general business expansion and production and an increase in registered capital of these entities. Amounts contributed to the statutory reserve were RMB47,287 and RMB64,831 as of December 31, 2006 and 2007, respectively.



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21. CHINA CONTRIBUTION PLAN AND PROFIT APPROPRIATION - continued

The general reserve is used to offset future extraordinary losses. The subsidiaries may, upon a resolution of the shareholders, convert the general reserve into capital. The staff welfare and bonus reserve is used for the collective welfare of the employees of the subsidiaries. The enterprise expansion reserve is used for the expansion of the subsidiaries' operations and can be converted to capital subject to approval by the relevant authorities. These reserves represent appropriations of retained earnings determined according to PRC laws and may not be distributed. RMB28,553 was appropriated to the reserves by Beijing Ninetowns Ports during the year ended December 31, 2005. According to the decision made by the board of directors in January 2007, RMB18,734 was appropriated from retained earnings to the statutory reserves by Ninetown's subsidiaries in the PRC; RMB17,544 were appropriated from current year's net income to statutory reserves by Ninetown's subsidiaries in the PRC.

Relevant PRC Statutory laws and regulations permit payments of dividends by Ninetown's PRC subsidiaries and VIEs only from their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. In addition, the general reserve, which requires annual appropriations of 10% of after-tax profit should be set aside prior to the payment of dividends. As a result of these PRC laws and regulations, the Company's PRC subsidiary and VIEs are restricted in their abilities to transfer funds to the Company in the form of dividends, loans or advances. Total restricted net assets of the Company's consolidated PRC subsidiaries and VIEs were RMB522,535 and RMB540,079 in 2006 and 2007, respectively.

22. SUBSEQUENT EVENTS

Subsequent to December 31, 2007, Guangzhou YueJiu has been in the process of liquidation.

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

SCHEDULE 1 - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY  
BALANCE SHEETS

(In thousands, except share and per share data)

	Years Ended December 31,		
	2006 RMB	2007 RMB	2007 US\$
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	73,589	33,354	4,572
Prepaid expenses and other current assets	9,041	5,754	789
Amounts due from subsidiaries	678,803	652,181	89,406
<b>Total current assets</b>	<b>761,433</b>	<b>691,289</b>	<b>94,767</b>
Investments in subsidiaries	548,403	385,162	52,801
<b>TOTAL ASSETS</b>	<b>1,309,836</b>	<b>1,076,451</b>	<b>147,568</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Other payables	4,856	3,443	472
Amounts due to subsidiaries	-	104	14
<b>Total current liabilities</b>	<b>4,856</b>	<b>3,547</b>	<b>486</b>
Shareholders' equity:			
Ordinary shares, par value RMB0.027 (HK\$0.025) per share:			
8,000,000,000 shares authorized; 34,991,834 shares issued and outstanding in 2006 and 2007			
	926	926	127
Additional paid-in capital	871,642	873,568	119,755
Retained earnings	441,343	210,176	28,813
Treasury shares, at cost, 47,862 shares and nil share in 2006 and 2007 respectively	(1,268)	-	-
Accumulated other comprehensive loss	(7,663)	(11,766)	(1,613)
<b>Total shareholders' equity</b>	<b>1,304,980</b>	<b>1,072,904</b>	<b>147,082</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>1,309,836</b>	<b>1,076,451</b>	<b>147,568</b>

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

SCHEDULE 1 - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY (CONTINUED)  
STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

	2005 RMB	Years ended December 31,		2007 US\$
		2006 RMB	2007 RMB	
General and administrative expenses	(21,702)	(20,509)	(21,682)	(2,972)
Loss from operations	(21,702)	(20,509)	(21,682)	(2,972)
Interest income	9,101	5,504	2,334	320
Other income	411	-	-	-
Loss before equity in earnings of subsidiaries	(12,190)	(15,005)	(19,348)	(2,652)
Equity in earnings of subsidiaries	163,794	60,933	(211,183)	(28,950)
Net income (loss)	151,604	45,928	(230,531)	(31,602)
Net income (loss) per share				
Basic	4.39	1.32	(6.59)	(0.90)
Diluted	4.25	1.30	(6.59)	(0.90)
Shares used in computation:				
Basic	34,539,976	34,773,005	34,966,830	34,966,830
Diluted	35,706,894	35,368,882	34,966,830	34,966,830

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NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED  
SCHEDULE 1 - CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY (CONTINUED)  
STATEMENTS OF SHAREHOLDERS' EQUITY AND  
COMPREHENSIVE INCOME  
(In thousands, except share and per share data)

	Ordinary shares Shares	Ordinary shares Amount RMB	Additional paid-in capital RMB	Treasury shares Shares	Treasury shares Amount RMB	Retained earnings RMB
Balance as of January 1, 2005	34,391,834	911	845,730	-	-	243,811
Ordinary shares converted to ADR shares for future exercises of share options	600,000	15	15,585	(600,000)	(15,600)	-
Issuance of ADR shares for the exercise of employee share options	-	-	-	284,774	7,404	-
Net income	-	-	-	-	-	151,604
Foreign currency translation adjustments	-	-	-	-	-	-
	-	-	-	-	-	-
Balance as of December 31, 2005	34,991,834	926	861,315	(315,226)	(8,196)	395,415
Issuance of ADR shares for the exercise of employee share options	-	-	-	267,364	6,928	-
Employee share options compensation cost	-	-	10,327	-	-	-
Net income	-	-	-	-	-	45,928
Foreign currency translation adjustments	-	-	-	-	-	-
	-	-	-	-	-	-
Balance as of December 31, 2006	34,991,834	926	871,642	(47,862)	(1,268)	441,343
Cumulative effect of unrecognized tax benefit on adoption of FIN 48	-	-	-	-	-	(636)
Issuance of ADR shares for the exercise of employee share options	-	-	-	47,862	1,268	-
Net income/(loss)	-	-	-	-	-	(230,531)
Foreign currency translation adjustments	-	-	-	-	-	-
Employee share options compensation cost	-	-	1,926	-	-	-
Unrealized gain on available-for-sale securities	-	-	-	-	-	-
	-	-	-	-	-	-
Balance as of December 31, 2007	34,991,834	926	873,568	-	-	210,176
		US\$127	US\$119,755	US\$ -	US\$ -	US\$28,811

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## NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

SCHEDULE 1 - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY (CONTINUED)  
STATEMENTS OF CASH FLOWS

(In thousands, except share and per share data)

	Years ended December 31,			
	2005	2006	2007	2007
	RMB	RMB	RMB	US\$
<b>Cash flows from operating activities:</b>				
Net income (loss)	151,604	45,928	(230,531)	(31,602)
Adjustments to reconcile net loss to net cash used in operating activities:				
Equity in earnings of subsidiaries	(163,794)	(60,933)	211,183	28,950
Changes in operating assets and liabilities:				
Prepaid expenses and other current assets	16,670	(8,889)	2,673	366
Other payables	(7,101)	1,305	(1,084)	(149)
Amounts due to subsidiaries	50	(516)	104	14
Net cash used in operating activities	(2,571)	(23,105)	(17,655)	(2,421)
<b>Cash flows from investing activities</b>				
Increase in amounts due from subsidiaries	(405,969)	(45,857)	(19,462)	(2,668)
Net cash used in investing activities	(405,969)	(45,857)	(19,462)	(2,668)
<b>Cash flows from financing activities:</b>				
Exercise of share options	7,404	6,928	1,268	174
Decrease in amounts due to shareholders	(5,360)	-	-	-
Net cash provided by financing activities	2,044	6,928	1,268	174
Effect of exchange rate changes	(15,635)	(3,519)	(4,386)	(601)
Net decrease in cash and cash equivalents	(422,131)	(65,553)	(40,235)	(5,516)
Cash and cash equivalents at the beginning of the year	561,273	139,142	73,589	10,088



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Cash and cash equivalents at the end of the year	139,142	73,589	33,354	4,572
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Notes to Schedule I:

Basis of preparation

The parent-company only condensed financial information of Ninetowns is prepared using the same accounting policies as set out in the Company's consolidated financial statements except that Ninetowns uses the equity method to account for its investments in subsidiaries.

Amounts due from and due to subsidiaries

Amounts due from subsidiaries represented amounts loaned to Ixworth for its investments in the Company's PRC subsidiaries. Amounts due from subsidiaries are non-interest bearing, unsecured and do not have specified payment terms. Amounts due to subsidiaries were payable within one year.

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